

Shareholder Wealth Maximization and Its Implementation Under Corporate Law

Bernard S. Sharfman

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SHAREHOLDER WEALTH MAXIMIZATION AND ITS
IMPLEMENTATION UNDER CORPORATE LAW

*Bernard S. Sharfman**

Interpretation begets interpretation, and a father's mistakes are corrected by the errors of his children. There is no reason to suppose, or to hope, that this will end. The substance of human existence is argument, and each of us has a footnote to contribute.¹

ABSTRACT

This Article tackles the question of when courts should intervene in the decision-making of a corporation and review a corporate business decision for shareholder wealth maximization. This Article takes a very traditional approach to answering this question. It notes with approval that courts have historically been very hesitant to participate in the process of determining if a corporate decision is wealth maximizing. Courts have restrained themselves from interfering with board decision-making because they understand that it is the board of directors (the board) in coordination with executive management that has the best information and expertise to determine if a corporate decision meets the objective of shareholder wealth maximization. Nevertheless, the courts have found that they can play a wealth-enhancing role if they focus on making corporate authority accountable when there is sufficient evidence to show that the corporate decision was somehow tainted. Therefore, the courts will interpose themselves as a corrective mechanism when a board decision is tainted with a conflict of interest, lack of independence, or where gross negligence in the process of becoming informed in the making of a business decision is implicated.

When judicial review veers from this traditional approach, the court's opinion must be closely scrutinized to see if the court had valid reasons for implementing a different approach. Such a veering from the traditional path can be found in the Delaware Chancery case of *eBay Domestic*

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1. A.O. Scott, *The Stuff of Life in Bitter Marginalia: 'Footnote,' a Satire and Family Drama by Joseph Cedar*, N.Y. TIMES (Mar. 8, 2012), <http://www.nytimes.com/2012/03/09/movies/footnote-a-satire-and-family-drama-by-joseph-cedar.html> (reviewing the film *Footnote*).

Holdings, Inc. v. Newmark, a case where the court, in its review of a shareholder rights plan under the *Unocal* test, required the directors to demonstrate that the corporate policy being defended by the poison pill enhanced shareholder value. As argued here, the court was wrong in its approach, and in general courts should never be in the position of adding this additional component of analyzing board decisions for shareholder wealth maximization unless the business decision was tainted with a conflict of interest, lack of independence, or gross negligence.

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INTRODUCTION

Shareholder wealth maximization is a norm² of corporate governance that encourages a firm's board of directors to implement all major decisions such as compensation policy, new investments, dividend policy, strategic direction, and corporate strategy with only the interests of shareholders in mind.³ There is strong support for the idea that shareholder wealth maximization should be the primary norm underlying the governance of for-profit corporations.⁴ Given this majority view, it should come as no surprise that many practitioners and scholars also consider shareholder wealth maximization to be the objective of corporate law,⁵ with corporate law's fiduciary duties of care and loyalty being the tools of accountability to enforce this objective.

As its theoretical foundation, this Article accepts shareholder wealth maximization as both the primary norm of corporate governance and the objective of corporate law.⁶ Therefore, any model of corporate law must explain why courts, outside reviewing for compliance with the board's *Revlon* duty, have historically shown little interest in reviewing a board decision to determine if shareholder wealth maximization was actually the

2. A norm can be described as “a rule that is neither promulgated by an official source, such as a court or legislature, nor enforced by the threat of legal sanctions, yet is regularly complied with.” JONATHAN R. MACEY, *CORPORATE GOVERNANCE: PROMISES KEPT, PROMISES BROKEN* 32–33 (2008) (quoting Richard A. Posner, *Social Norms and the Law: An Economic Approach*, 87 AM. ECON. REV. (PAPERS & PROC.) 365, 365 (1997)) (internal quotation marks omitted).

3. *Id.* at 7.

4. *Id.* at 4. According to Professor Macey, “Corporations are almost universally conceived as economic entities that strive to maximize value for shareholders.” *Id.* at 2. Nevertheless, the role of shareholder wealth maximization in corporate governance still can create an interesting debate. See, for example, a recent series of thought-provoking posts and comments on two blogs, *The Conglomerate* and *ProfessorBainbridge.com*, debating the role of shareholder wealth maximization in corporate governance. Haskell Murray, *Benefit Corporations: Traditional Paradigm*, CONGLOMERATE (May 3, 2012), <http://www.theconglomerate.org/2012/05/benefit-corporations-corporate-purpose.html>; *The Vacuity of Corporate Purpose*, PROFESSORBAINBRIDGE.COM (May 5, 2012), <http://www.professorbainbridge.com/professorbainbridgecom/2012/05/the-vacuity-of-corporate-purpose.html>.

5. According to Professor Macey, “For many, particularly those in the law and economics movement, any action by managers, directors, or others that is inconsistent with the goal of shareholder wealth maximization is considered a form of ‘corporate deviance.’” MACEY, *supra* note 2, at 2.

6. See Parts I and II for a more detailed discussion of shareholder wealth maximization as the primary norm of corporate governance and as the objective of corporate law, respectively.

board's objective. To explain why courts have used this restrained approach, this Article utilizes a model of corporate law that describes a world where the courts have designated the board of directors as the locus of authority for determining whether a corporate decision maximizes shareholder wealth.⁷ Courts take this approach because they understand that it is the board (not the courts) that has the information and expertise to determine if a corporate decision meets this objective.⁸

This approach to judicial review is implemented by utilizing a strategy of protecting managerial discretion in corporate decision-making as evidenced by the business judgment rule.⁹ A court will only interpose itself in this shareholder wealth-maximizing determination if the board decision is tainted with a conflict of interest, lack of independence, or where the board, when in the process of making a business decision, is grossly negligent in informing themselves of all material information in instances where exculpation clauses do not apply.¹⁰ When a court utilizes this triad of filters prior to a review for shareholder wealth maximization, it can take both a light-handed and intermittent approach to board accountability, consistent with an Arrowian framework that sees great value in decision-making by a centralized authority.¹¹

The model just described can be understood as the traditional model of corporate law and, as argued here, it is still valid. Thus, when a chancellor or judge veers from this model, the judicial opinion must be closely scrutinized to see if the court had valid reasons for implementing a different approach. Such a veering from the traditional path can be found in *eBay Domestic Holdings, Inc. v. Newmark*,¹² a recent Delaware Chancery Court case. There, former Chancellor William B. Chandler, in his review of a shareholder rights plan under the *Unocal* test, required the directors of craigslist to demonstrate that the corporate policy being defended under the first prong of the test enhanced shareholder value (the Link).¹³ The Link was required even though the decision to implement the rights plan was neither ripe nor required to be reviewed under the established triad of filters.¹⁴ This Article argues that former Chancellor Chandler was wrong in adding shareholder wealth maximization as an additional burden for the board to bear under the first prong of the *Unocal* test.

7. See Part III.

8. See Part III.

9. See Section III.B.

10. See Section III.B.

11. See Subection III.B.1. For a discussion of how the triad of filters can be applied without the business judgment rule but with the same effect, see Lyman Johnson, *Unsettledness in Delaware Corporate Law: Business Judgment Rule, Corporate Purpose*, 38 DEL. J. CORP. L. 405, 423–31 (2013).

12. 16 A.3d 1 (Del. Ch. 2010).

13. *Id.* at 30–31.

14. *Id.*

The discussion that follows, when it references state corporate law, is pragmatically framed in the context of Delaware corporate law. Delaware is the state where the majority of the largest U.S. companies are incorporated,¹⁵ and its corporate law often serves as the authority that other U.S. states and countries look to when developing their own statutory and case law.¹⁶ Therefore, the primary examples are from Delaware, but the thinking is meant to be global in nature.

Part I describes shareholder wealth maximization as a norm of corporate law. Part II describes shareholder wealth maximization as an objective of corporate law. Part III explains why courts avoid the review for shareholder wealth maximization, but also describes the situations in which they are required to conduct such a review. Part IV describes how courts have begun to transform the *Revlon* duty to be consistent with Delaware's traditional approach to the review for shareholder wealth maximization. Part V describes how *eBay* creates a new exception. Part VI explains the impact of *eBay*.

I. SHAREHOLDER WEALTH MAXIMIZATION AS A NORM OF CORPORATE GOVERNANCE

There is widespread support for the idea that shareholder wealth maximization should be the primary norm underlying corporate governance.¹⁷ It is widely accepted that shareholder wealth maximization enhances corporate decision-making and can be understood as a proxy for social welfare maximization.¹⁸ According to Professor Jeffrey Gordon, this norm has been reinforced by the transition over the last sixty years from a typical corporate board of a public company comprised of a minority of independent directors to one that is dominated by them, allowing for a dramatic shift in board focus from managerialism, i.e., the goals of management, to shareholder wealth maximization.¹⁹ Professor Gordon

15. According to the State of Delaware web site, Delaware is the legal home to more than 50% of all U.S. publicly-traded companies and 64% of the Fortune 500. *Why Incorporate in Delaware?*, DEL. DIVISION OF CORPS., <http://corp.delaware.gov> (last visited Mar. 11, 2014); see also LEWIS S. BLACK, JR., *WHY CORPORATIONS CHOOSE DELAWARE 1* (2007) (stating that Delaware is the “favored state of incorporation for U.S. businesses”).

16. Nadelle Grossman, *Director Compliance with Elusive Fiduciary Duties in a Climate of Corporate Governance Reform*, 12 *FORDHAM J. CORP. & FIN. L.* 393, 397 (2007).

17. See sources cited *supra* note 4.

18. As Professor John Boatright summarizes, “[C]orporate decision making is more efficient and effective when management has a single, clearly-defined objective, and shareholder wealth maximization provides not only a workable decision guide but one that, if pursued, increases the total wealth creation of the firm.” John R. Boatright, *What’s Wrong—and What’s Right—with Stakeholder Management*, 21 *J. PRIVATE ENTERPRISE*, Spring 2006, at 106, 118 (citation omitted); accord William W. Bratton & Michael L. Wachter, *Shareholders and Social Welfare*, 36 *SEATTLE U. L. REV.* 489, 502 (2013) (noting how shareholder wealth maximization is not the same thing as social welfare but can be used as a proxy for its maximization).

19. Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950–2005*:

attributes this shift in focus to the theory that independent directors, unlike the insiders and interested outsiders who dominated corporate boards in the 1950s, “are less committed to management and its vision.”²⁰ “Instead, they look to outside performance signals,” such as information provided by the stock market, to assess the firm’s performance.²¹ Professor Gordon also notes that enhanced SEC disclosure requirements and more transparent accounting standards have facilitated this focus. These factors allow stock prices to reflect corporate information that once had been known only to insiders; thus, stock prices are now much better indicators of company performance.²² According to Professor Gordon, “The overriding effect is to commit the firm to a shareholder wealth-maximizing strategy as best measured by stock price performance.”²³

Other factors that have further enforced the norm of shareholder wealth maximization are a decline over the last thirty years of companies using defined-benefit plans and conversely the rise in defined-contribution plans as the primary means to fund retirement benefits.²⁴ Since defined-contribution plans strongly depend on capital markets and not the ability of employer contributions to maintain benefit levels, shareholder wealth and its growth have become more important for larger segments of society. This trend has created public pressure on corporate boards to keep their share prices growing while, at the same time, reducing their ability to take into account the interests of other stakeholders.²⁵

II. SHAREHOLDER WEALTH MAXIMIZATION AS THE OBJECTIVE OF CORPORATE LAW

Most recently, as society has come to absorb the corporate governance lessons learned from the financial crisis of 2007–08, the shareholder wealth maximization norm has come under heavy and fair criticism from leading corporate governance scholars such as Professors Lynn Stout²⁶ and

Of Shareholder Value and Stock Market Prices, 59 STAN. L. REV. 1465, 1540 (2007). Professor Gordon reports that from 1950 to 2005 the percentage of independent directors serving on the typical board of a public company has increased from 22% to 74%. *Id.* at 1565 tbl.1.

20. *Id.* at 1563.

21. *Id.*

22. *Id.* at 1541–43.

23. *Id.* at 1563.

24. Martin Gelter, *The Pension System and the Rise of Shareholder Primacy*, 43 SETON HALL L. REV. 909, 911–12 (2013).

25. *Id.*

26. *E.g.*, LYNN STOUT, *THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC* (2012). Professor Stout has been arguing that shareholder wealth maximization is not the appropriate corporate objective since at least 1999. *See* Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 249 (1999) (“In this Article we take issue with . . . the shareholder wealth maximization goal . . .”).

Jay Lorsch.²⁷ Moreover, there are alternative models of corporate governance that do not incorporate shareholder wealth maximization as the objective. For example, Professors Margaret Blair and Lynn Stout use their team-production approach to corporate governance to argue that shareholder wealth maximization is not the correct objective of a public company.²⁸

27. Justin Fox & Jay W. Lorsch, *What Good are Shareholders?*, HARV. BUS. REV., July–Aug. 2012, at 48.

28. Blair & Stout, *supra* note 26, at 249. Professors Blair and Stout model the public company as a team of members who make firm-specific investments in the corporation with the goal of producing goods and services as a team (“team production”), with the board of directors serving as a “mediating hierarchy.” *Id.* at 271–76. In this role, board members are “mediating hierarchs whose job is to balance team members’ competing interests in a fashion that keeps everyone happy enough that the productive coalition stays together.” *Id.* at 281. As a mediating hierarchy, the board acts in a detached manner from the team members. It is a *sui generis* body that acts as a group of trustees, not agents. *Id.* at 290. The board is the ultimate decision-making authority within the corporation, and it is constrained only by the fiduciary duties imposed by corporate law and its desire to do its job in the most efficient manner. *Id.* Because the board is endowed with such authority, it has the freedom to most efficiently balance the interests of the team members with those of the shareholders. *Id.* at 291.

Any person or entity that makes a specialized investment that has little or no value outside the joint enterprise, a “firm-specific” investment, is a member of the team. *Id.* at 272. The result is “that *no one team member is a ‘principal’* who enjoys a right of control over the team.” *Id.* at 277. Team members are primarily made up of executives, rank-and-file employees, and equity investors, but can also include researchers, creditors, the local community, marketers, and vendors who provide specialized products and services to the firm. *Id.* at 288. For example, if a team of researchers tries to develop a new drug, then those researchers may have to invest many years of specialized effort and skill that may only be useful to the firm that employs them, but is worthless to all other firms. *Id.* at 265–66. Another example is when a vendor invests heavily in its production facilities to produce a customized product for the firm. Or when a municipality offers a large package of tax abatements, credits, worker training, etc. to entice the firm to build or expand plant capacity in the community, which brings to the area a significant number of new jobs. Like equity investors, these stakeholders have made firm-specific investments and therefore must be considered residual interest holders, protected only by long-term implicit agreements (noncontractual and therefore not legally enforceable) that they enter into because they trust the board of directors to do its best to ensure they recoup their investments. *See id.* at 274–76.

Professor Alan Meese does an excellent job in summarizing Blair and Stout’s argument regarding why the board as a mediating hierarchy provides value in comparison to a board being guided only by the norm of shareholder wealth maximization:

According to Blair and Stout, the public corporation is best viewed as a team of shareholders, creditors, workers, managers, and communities. Shareholders are not the only group that make investments that are specific to this “team”: creditors, workers, managers, and communities also make investments that are most productive when employed in connection with the corporate enterprise. Like shareholders, who face the risk of opportunism by managers, these other constituencies run the risk of exploitation by shareholders. As a result, it is said, these groups may be reluctant to place their human and financial capital under the control of managers and directors obligated under the shareholder primacy norm “ruthlessly [to] pursue shareholders’ interests.” Thus, instead of overseeing

Nevertheless, in the world of corporate law, especially by those who take a law and economics approach to corporate law, the objective of shareholder wealth maximization is firmly entrenched.²⁹ According to Professors Henry Hansmann and Reiner Kraakman, “There is no longer any serious competitor to the view that corporate law should principally strive to increase long-term shareholder value.”³⁰ According to Judge Frank Easterbrook and Professor Daniel Fischel, one can think of shareholder wealth maximization as the default rule under corporate law because it is the “operational assumption of successful firms.”³¹ Much more recently, Chancellor Leo E. Strine Jr. of the Delaware Chancery Court stated his own view in a *Wake Forest Law Review* article that “the corporate law *requires* directors, as a matter of their duty of loyalty, to pursue a good faith strategy to maximize profits for the stockholders,”³² and that directors should only receive the benefit of the business judgment rule if their decision was motivated by a desire to enhance shareholder value.³³ While not judicial precedent, Chancellor Strine’s scholarly writings that promote the role of shareholder wealth maximization in corporate law presumably have some influence on the legal thinking of judges and other Delaware chancellors when they consider issues involving corporate decision-making.

Shareholder wealth maximization is also prominent in “theoretical” models of corporate law. For example, in a principal-agent model of corporate law, shareholders are viewed as the owners of the corporation and the board of directors and executive officers are their agents:

[E]nterprises choose the corporate form over other types of business organization to realize the gains produced by the separation of ownership from control. This separation enables

managers with a view toward maximizing the wealth of shareholders, they say, directors do and should view themselves as “mediating hierarchs” who resolve competing claims to the collective residual produced by the firm’s activities.

Alan J. Meese, *The Team Production Theory of Corporate Law: A Critical Assessment*, 43 WM. & MARY L. REV. 1629, 1632 (2002) (alteration in original) (footnotes omitted).

29. See *supra* note 5.

30. Henry Hansmann & Reiner Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 439 (2001) [hereinafter Hansmann & Kraakman, *The End*]; see also Henry Hansmann & Reiner Kraakman, *Reflections on the End of History for Corporate Law*, in THE CONVERGENCE OF CORPORATE GOVERNANCE: PROMISE AND PROSPECTS 32 (Abdul A. Rasheed & Toru Yoshikawa eds., 2012) (suggesting that events over the last ten years have not changed the relationship between shareholder wealth maximization and corporate law).

31. FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 36 (1991).

32. Leo E. Strine, Jr., *Our Continuing Struggle with the Idea that For-Profit Corporations Seek Profit*, 47 WAKE FOREST L. REV. 135, 155 (2012) (emphasis added).

33. *Id.* at 147–48 (“Fundamental to the rule . . . is that the fiduciary be motivated by a desire to increase the value of the corporation for the benefit of the stockholders.”).

a specialization of function: Shareholders supply capital and bear the risk that comes with their claim to the firm's residual product, and managers act as shareholders' agents, using their expertise to deploy the principals' capital in various ventures.

. . . This "principal-agent" account of the public corporation, in turn, implies a "shareholder primacy norm," i.e., a recognition that directors and managers do and should run the corporation so as to maximize the wealth of a single owner, namely, shareholders.³⁴

Shareholders employ directors and officers to run the company on their behalf and therefore these agents' goal should be shareholder wealth maximization. The results of corporate decisions that do not focus on shareholder wealth maximization are referred to as agency costs.³⁵ Hence, corporate law should be structured to minimize such costs.³⁶

Alternatively, under a nexus of contracts or "contractarian" model of the corporation, shareholders are not perceived to own the corporation but are considered to be only one of many parties that contract with the corporation.³⁷ Nevertheless, the board of directors still has fiduciary duties to maximize shareholders wealth.³⁸ This is a result of the hypothetical bargain struck between shareholders and the other parties in the corporation (or with the board of directors as in Professor Stephen M. Bainbridge's director primacy model of corporate law).³⁹ In this hypothetical bargain, shareholders would argue that since they are the least contractually protected versus other parties, they deserve shareholder wealth maximization as the gap filler in their corporate contract.⁴⁰

34. Meese, *supra* note 28, at 1631 (footnotes omitted).

35. *Id.*

36. *Id.* Of course, even though directors have fiduciary duties, corporate law does not perceive them as agents of shareholders. RESTATEMENT (SECOND) OF AGENCY § 14C (1958) ("Neither the board of directors nor an individual director of a business is, as such, an agent of the corporation or of its members."); *see also* United States v. Griswold, 124 F.2d 599, 601 (1st Cir. 1941) ("The directors of a corporation for profit are 'fiduciaries' having power to affect its relations, but they are not agents of the shareholders since they have no duty to respond to the will of the shareholders as to the details of management." (quoting RESTATEMENT (FIRST) OF AGENCY § 14(c) cmt. c (1933)) (internal quotation mark omitted)); Arnold v. Soc'y for Sav. Bancorp, 678 A.2d 533, 539–40 (Del. 1996) ("Directors, in the ordinary course of their service as directors, do not act as agents of the corporation A board of directors, in fulfilling its fiduciary duty, controls the corporation, not *vice versa*." (citing RESTATEMENT (SECOND) OF AGENCY § 14C (1958))).

37. Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 547–48 (2003).

38. *Id.* at 548.

39. *See id.* at 547–48.

40. *See id.*; *see also id.* at 579.

In the models just described, a board of directors has a legal obligation to manage according to shareholder interests.⁴¹ Such a legal obligation is enforced through the fiduciary duties of care and loyalty that a board of directors and its executive management owes to their shareholders.⁴² Thus, under these models, fiduciary duties are the tools of accountability with the objective of shareholder wealth maximization. In addition, shareholders can effectively enforce these legal obligations by filing direct and derivative lawsuits.

Yet corporate law has shown very little interest in directly enforcing the objective of shareholder wealth maximization. This lack of interest is evidenced in all aspects of corporate law. First, Delaware General Corporation Law is silent on shareholder wealth maximization.⁴³ Second, court opinions rarely reference shareholder wealth maximization as a guiding principle of corporate law and when they do it is mainly to discuss the *Revlon* duty,⁴⁴ i.e., the board's duty "to seek the best available price . . . when a company embarks on a transaction—on its own initiative or in response to an unsolicited offer—that will result in a change of control."⁴⁵ Third, in most cases the business judgment rule can nullify the fiduciary duty of care.⁴⁶ Likewise, in all duty of care cases where director liability is at issue, an exculpation clause in a corporation's certificate of incorporation can nullify the fiduciary duty of care.⁴⁷ Therefore, if in an

41. Hansmann & Kraakman, *The End*, *supra* note 30, at 440–41.

42. MACEY, *supra* note 2, at 5. This Article adopts the current Delaware approach by recognizing only two fiduciary duties—care and loyalty. All other duties, such as the *Revlon* duty, the duty to monitor, the duty of candor, etc., are to be understood as the application in a specific context of the board's two aforementioned fiduciary duties. For example, in *Stone v. Ritter*, the Delaware Supreme Court stated in the context of discussing good faith:

First, although good faith may be described colloquially as part of a "triad" of fiduciary duties that includes the duties of care and loyalty, the obligation to act in good faith does not establish an independent fiduciary duty that stands on the same footing as the duties of care and loyalty. *Only the latter two duties, where violated, may directly result in liability*, whereas a failure to act in good faith may do so, but indirectly.

911 A.2d 362, 370 (Del. 2006) (emphasis added) (footnote omitted).

43. Instead, Delaware General Corporation Law simply states that corporations can be formed "to conduct or promote any lawful business or purposes." DEL. CODE ANN. tit. 8, § 101(b) (West, Westlaw through 79 Laws 2013, chs. 1–13, 19).

44. *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986) (establishing the *Revlon* duty to maximize shareholder wealth when the break-up, sale, or merger of a company is inevitable).

45. *Lyondell Chem. Co. v. Ryan*, 970 A.2d 235, 242 (Del. 2009).

46. The exception to this duty of care "safe harbor" provided by the business judgment rule is that directors must be informed when making a business decision. The standard of review is gross negligence. *See Smith v. Van Gorkom*, 488 A.2d 858, 873 (Del. 1985), *overruled on other grounds by Gantler v. Stephens*, 965 A.2d 695 (Del. 2009).

47. DEL. CODE ANN. tit. 8, § 102(b)(7). Under § 102(b)(7), shareholders are allowed to

overwhelming number of cases courts are not enforcing the fiduciary duty of care, then how can it be said that this fiduciary duty is achieving the objective of shareholder wealth maximization?

Fourth, a judicial review for a breach of the directors' duty of loyalty is never triggered because a board decision has allegedly failed to maximize shareholder wealth. A review for a breach of the duty of loyalty is only triggered when a decision is either tainted or presumed tainted by a conflict of interest, a lack of independence, or both.⁴⁸ Corporate law makes the critical presumption that conflicts of interest or lack of independence must lead to erroneous decision-making, and will find directors liable for the harm caused by such decisions.⁴⁹ This presumption is justified based on the logic that if a decision is tainted with self-interest, then there is no basis for believing that the decision was made in the best interests of the corporation or its shareholders.⁵⁰ Thus, "there is no reason to preserve the authority of the board."⁵¹ When a board decision is so tainted, then a court will review it under a fairness standard with the burden of proof shifted to the directors.

III. WHY COURTS AVOID THE REVIEW FOR SHAREHOLDER WEALTH MAXIMIZATION

The focus on taint means that the courts are using the presence of agency costs as a filter for determining whether to get involved in a review for shareholder wealth maximization. The courts take this approach because they recognize that fiduciary duties—that is, as tools for achieving the objective of shareholder wealth maximization—must take a back seat to the primary strategy used by corporate law to achieve this objective: the protection and promotion of board authority, or what can simply be

incorporate into their certificate of incorporation:

A provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director: (i) For any breach of the director's duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; . . . ; or (iv) for any transaction from which the director derived an improper personal benefit.

Id.

48. See *Rich ex rel. Fuqi Int'l, Inc. v. Yu Kwai Chong*, 66 A.3d 963, 975 (Del. Ch. 2013) (noting that "a conflict of interest or lack of independence" when a board of directors was "render[ing] a [decision]" could "violat[e] its duty of loyalty" (citing *Rales v. Blasband*, 634 A.2d 927, 934 (Del. 1993))).

49. Michael P. Dooley, *Two Models of Corporate Governance*, 47 *BUS. LAW.* 461, 487 (1992).

50. *Id.* Rather, "the contrary inference seems more likely." *Id.*

51. *Id.*

referred to as “managerial discretion.”⁵² Preserving managerial discretion necessarily means that fiduciary duties will be weak and that courts will primarily refrain from determining whether a decision maximizes shareholder wealth. The problem is that this approach is counterintuitive and therefore subject to being misunderstood, especially by those who have been trained in the law and believe that accountability should always be the default rule.

Corporate law, however, takes a more pragmatic approach than the courts. It says that agency costs are a part of corporate decision-making, and that these costs must be tolerated to a certain degree to make sure that corporate decision-making comes as close to shareholder wealth maximization as possible. This requires that the locus of authority for corporate decisions, and therefore the determination of what is a shareholder wealth-maximizing decision, be vested in the board of directors and not shareholders or the courts.⁵³

To understand corporate law’s strategy, it might be helpful to visualize a line with absolute managerial discretion at one end and absolute accountability at the other, as represented by judicial review of every board decision for a breach of fiduciary duties. On this line there is an optimal point between absolute authority and absolute accountability that allows for shareholder wealth maximization. Corporate law, even though it does not know exactly where this optimal point may lie at any point in time, has taken the position that the optimal point must reside much closer to absolute authority than to absolute accountability. In identifying where that balancing point may be, a court takes a very pragmatic approach to how much accountability it should require in its review of corporate decisions. It does so by trying to identify whether a board decision is tainted with interestedness, lack of independence, or gross negligence. This approach provides accountability, but at the same time defers the substantive component of corporate decision-making to the board of directors.

However, this is not necessarily the way it must always be. Corporate law may over time shift the substantive component of corporate decision-making away from the board of directors to stockholders or the courts if it becomes clear that this will benefit the objective of shareholder wealth maximization. As discussed below, there are several good arguments why the locus of authority must remain with the board of directors for the foreseeable future to maximize shareholder wealth. These arguments validate Professor Bainbridge’s argument that under corporate law the “[p]reservation of managerial discretion should always be the null hypothesis.”⁵⁴

52. See Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 109 (2004).

53. *Cf. id.* at 84–85.

54. *Id.* at 109.

A. *The Foundation: The Board of Directors as the Locus of Authority Under Statutory Law*

Delaware General Corporation Law § 141(a) provides the legal foundation for the board of directors to be a corporation's locus of authority: "The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation."⁵⁵ While it is possible for a corporation to contract away from this default rule by modifying its certificate of incorporation or becoming a statutory close corporation,⁵⁶ it is quite clear that statutory law takes the position that the correct locus of authority for corporate decision-making lies with the board of directors.

But Delaware General Corporation Law does not stop with § 141(a) in promoting board authority. It also provides that only the board can decide if a dividend is to be paid;⁵⁷ the board has authority to make significant acquisitions without shareholder approval if the board decides to acquire another company, as long as the board does not dilute existing shareholders by more than 20% or pays for the acquisition in cash;⁵⁸ the board can sell company assets without shareholder approval as long as it does not sell substantially all of its assets;⁵⁹ the board is not required to follow the commands of its shareholders, even if shareholders pass a unanimous resolution requesting the board to act in a specific manner;⁶⁰ the board has sole discretion to initiate changes to the corporate charter;⁶¹ shareholders are required to make a demand before filing a derivative suit or must demonstrate demand futility;⁶² and, as already mentioned, a corporation may include exculpation clauses in its charter,⁶³ relieving the directors of duty of care liability. In sum, statutory corporate law endorses the board of directors as being the locus of authority for determining when a decision is shareholder wealth-maximizing.

55. DEL. CODE ANN. tit. 8, § 141(a) (West, Westlaw through 79 Laws 2013, chs. 1–13, 19).

56. *Id.* § 351.

57. *See id.* § 170.

58. *See id.* § 251(f).

59. *Id.* § 271.

60. Blair & Stout, *supra* note 26, at 291.

61. DEL. CODE ANN. tit. 8, § 242(b)(1). This is a very powerful tool to keep shareholders from disturbing the balance of power that is and should be tilted in favor of centralized authority. In certain states, shareholders may amend the corporate charter without board approval. For example, see OHIO REV. CODE ANN. § 1701.71(A)(1) (LexisNexis, LEXIS through Aug. 16, 2013).

62. DEL. CH. CT. R. 23.1(a); Aronson v. Lewis, 473 A.2d 805 (Del. 1984), *overruled on other grounds by* Brehm v. Eisner, 746 A.2d 244 (2000).

63. *See supra* note 47 and accompanying text.

1. The Value of Authority

Statutory corporate law promotes the board of directors as the locus of authority because it recognizes that a centralized, hierarchical authority is necessary for the successful management of a *large* organization. It is not the perfect locus of authority, only the best one that is currently available.⁶⁴ In terms of corporations, public companies immediately come to mind when one thinks of large organizations. Public companies can be thought of in broad terms as those whose shares trade on a public stock exchange and do not have a controlling shareholder. Of course, large corporations such as Apple, General Electric, Microsoft, ExxonMobil, and General Motors are public companies, but the term “large organizations” also covers the thousands of other corporations that are smaller but still of significant size. The definition also includes publicly-traded companies with controlling shareholders such as Google, Facebook, and LinkedIn, and large companies such as Cargill, Inc. and Mars, Inc. that take the corporate form but whose shares are privately held.

Statutory corporate law’s promotion of board authority can be justified based on Kenneth Arrow’s theory of large organizations.⁶⁵

Arrow’s [theory] starts out with the basic proposition that “authority is needed to achieve a coordination of the activities of the members of the organization.” But, more importantly, centralized authority enhances organizational efficiency. According to Arrow, efficiency is created in a large organization because “the centralization of decision-making serves to economize on the transmission and handling of information.” Arrow’s theory on how centralized authority creates value is based on four propositions:

64. Directors, as human beings, have limitations on their ability to foresee all possibilities and choose the path that will allow a corporation to truly maximize shareholder wealth. Dooley, *supra* note 49, at 469. The board of directors, even acting as a group, cannot overcome this limitation on human cognitive ability even though it can be argued that a board, as a small group, can make better decisions than a decision maker acting alone. See Stephen M. Bainbridge, *Why a Board? Group Decisionmaking in Corporate Governance*, 55 VAND. L. REV. 1, 19 (2002).

65. KENNETH J. ARROW, *THE LIMITS OF ORGANIZATION* 68–70 (1974). Professor Michael Dooley was the first to make the connection between the work of Kenneth Arrow and the structure of Delaware corporate law. Dooley, *supra* note 49, at 467. Professor Bainbridge has adopted Professor Dooley’s application of Arrow’s theory and readily acknowledges the contribution Professor Dooley has made in the development of his director primacy model. See Bainbridge, *supra* note 52, at 85 n.11 (“I should acknowledge the debt director primacy owes to Professor Dooley’s so-called ‘Authority Model,’ . . .”). For a good criticism of Professor Bainbridge’s application of Arrow’s work, see Brett H. McDonnell, *Professor Bainbridge and the Arrowian Moment: A Review of The New Corporate Governance in Theory and Practice*, 34 DEL. J. CORP. L. 139, 143 (2009) (describing Professor Bainbridge’s argument in applying Arrow’s work).

1. Since the activities of individuals interact with each other, being sometimes substitutes, sometimes complements, and frequently compete for limited resources, joint decision on the choice of individuals' activities will be superior to separate decisions.
2. The optimum joint decision depends on information which is dispersed among the individuals in the society.
3. Since transmission of information is costly, in the sense of using resources, especially the time of the individuals, it is cheaper and more efficient to transmit all the pieces of information once to a central place than to disseminate each of them to everyone.
4. For the same reasons of efficiency, it may be cheaper for a central individual or office to make the collective decision and transmit it rather than retransmit all the information on which the decision is based.

For an organization to be successful in its decision making, its decisions must be based on adequate information and made in a timely manner. This requires the organization "to facilitate the flow of information to the greatest extent possible." Such facilitation requires "the reduction of the volume of information while preserving as much of its value as possible." Centralized authority allows for "superior efficiency" by minimizing the number of⁶⁶ communication channels required in a large organization.

In sum, information scattered throughout a large organization must be both filtered and transmitted to a centralized authority in order for a large organization to make informed decisions and minimize error in decision-making.⁶⁷

a. The Value of Authority and Large Corporations

As Professors Bainbridge and Dooley so astutely point out in their writings, the value of authority is of major benefit to public companies, i.e., publicly-traded corporations without controlling shareholders.⁶⁸ But it is not necessary to limit Professor Arrow's theory to just public companies. All large organizations that take the corporate form, even with controlling

66. Bernard S. Sharfman, *The Enduring Legacy of Smith v. Van Gorkom*, 33 DEL. J. CORP. L. 287, 294–95 (2008) (footnotes omitted) (quoting ARROW, *supra* note 65, at 68–70).

67. ARROW, *supra* note 65, at 68–70.

68. See Bainbridge, *supra* note 37, at 559; Dooley, *supra* note 49, at 471–72.

shareholders, such as Google or Cargill, Inc.,⁶⁹ benefit from centralized authority and professional management. These companies have tens of thousands of employees and have made huge investments in plant, equipment, and real property holdings. In such companies “pieces of information may be scattered over different states, countries, and even continents.”⁷⁰ “To have the holders of these scattered bits of information,” including the overwhelming majority of shareholders, make decisions that affect the company as a whole would lead to suboptimal decision-making.⁷¹ Therefore, it is much more efficient for the board of directors and executive management—the corporate actors that possess an overwhelming information advantage—to make corporate decisions rather than shareholders.⁷² “The need to make informed decisions provides corporate law a very good reason to minimize the role of shareholders,” the courts, and other uninformed stakeholders in a large company’s decision-making process.⁷³

b. The Protection of Board Authority and Small Companies

What may be somewhat puzzling is that statutory corporate law protects not only the board authority of large organizations, but small ones as well. Why statutory corporate law would provide for the zealous protection of board authority to small close corporations makes sense if one divides small close corporations into two types: the first type is a company with ambitions to grow significantly in terms of employment, plants, equipment, and real property so as to become the next Apple, Microsoft, or IBM; the second is a company with no expectation of becoming much larger than when first organized. The first type may benefit greatly from corporate law’s protection of board authority by freely maneuvering and implementing a growth strategy without shareholder interference.⁷⁴ However, this is not true of the second type of close corporation and is

69. For example, the *Wall Street Journal* reported that most of the stock in Cargill, Inc. is owned by about 100 people who are descendants of the founding families. See Gina Chon, Anupreeta Das & Scott Kilman, *Cargill to Give Up Mosaic Stake in \$24.3 Billion Deal*, WALL ST. J. (Jan. 19, 2011), <http://online.wsj.com/article/SB10001424052748703954004576090290720390356.html> (subscription required).

70. Bernard S. Sharfman, *What’s Wrong with Shareholder Empowerment?*, 37 J. CORP. L. 903, 905 (2012).

71. *Id.*

72. *See id.*

73. *Id.*

74. Bernard S. Sharfman, *Why Proxy Access Is Harmful to Corporate Governance*, 37 J. CORP. L. 387, 395–96 (“Why a corporation would decide to produce what it needs internally under a command and control structure—and thereby potentially grow to great size—and not simply purchase from external sources, is a function of *transaction costs* and the marginal analysis that goes into determining which is the better alternative.” (citing Ronald H. Coase, *The Nature of the Firm*, 4 *ECONOMICA* 386, 393–97 (1937))).

most likely a major reason why, excluding the benefit of pass-through taxation, small companies have gravitated toward becoming Limited Liability Companies (LLCs) and not corporations.⁷⁵

2. The Value of Accountability

Statutory corporate law, however, does not allow the board of directors to wield its authority without any accountability. Statutory corporate law is most concerned that “unaccountable authority may be exercised opportunistically.”⁷⁶ Such opportunistic behavior includes corporate management shirking its duties or trying to extract private benefits from the corporation.⁷⁷ These types of behavior lead to agency costs in large corporations.⁷⁸ Examples of statutory and regulatory tools of accountability used to combat such opportunistic behavior include required shareholder approval of major corporate actions such as merger agreements,⁷⁹ a shareholder’s right to inspect a corporation’s books and records for a proper purpose,⁸⁰ required shareholder approval for changes to the articles of incorporation,⁸¹ the power of shareholders to unilaterally propose and adopt bylaws,⁸² proxy contests, and director independence requirements for companies listed on U.S. stock exchanges.⁸³

75. John C. Coates IV, *Measuring the Domain of Mediating Hierarchy: How Contestable Are U.S. Public Corporations?*, 24 J. CORP. L. 837, 843 (1999) (noting that LLC statutes were written with close corporations in mind).

76. Bainbridge, *supra* note 52, at 107.

77. Dooley, *supra* note 49, at 464–65. According to Professor Dooley, “Although opportunism is often equated with ‘cheating,’ for present purposes it will be useful to think of opportunism as embracing all failures to keep previous commitments, whether such failures result from culpable cheating, negligence, ‘understandable’ oversight, or plain incapacity.” *Id.* at 465.

78. Paul Rose, *Common Agency and the Public Corporation*, 63 VAND. L. REV. 1355, 1361 (2010) (citing Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, 3 J. FIN. ECON. 305, 305–06 (1976)). As Professor Rose explains:

Under a classic theory of the firm, agency costs in the corporate context increase as ownership is separated from control. As the manager’s ownership of shares in the firm decreases as a percentage of the total, the manager will bear a diminishing fraction of the costs of any nonpecuniary benefits he takes out in maximizing his own utility. To prevent the manager from maximizing his utility at the expense of the shareholders, shareholders will seek to constrain the manager’s behavior by aligning the manager’s interests with the shareholders’ interests.

Id. at 1361 (footnotes omitted).

79. DEL. CODE ANN. tit. 8, § 251(c) (West, Westlaw through 79 Laws 2013, chs. 1–13, 19).

80. *Id.* § 220(b).

81. *Id.* § 242.

82. *Id.* § 109.

83. Eric M. Fogel & Andrew M. Geier, *Strangers in the House: Rethinking Sarbanes-Oxley and the Independent Board of Directors*, 32 DEL. J. CORP. L. 33, 35 (noting that the stock exchanges require that a majority of directors be independent).

This light but significant level of statutory accountability is again consistent with Professor Arrow's understanding of large organizations.⁸⁴ The centralized authority needs to be held accountable for its decisions or else it may act irresponsibly with the "likelihood of unnecessary error."⁸⁵ However, an increase in corporate law's tools of accountability does not necessarily result in enhanced corporate decision-making. The fear is that in the process of trying to correct errors resulting from irresponsible decisions, "the genuine values of authority" will be destroyed.⁸⁶ Such "a sufficiently strict and *continuous* organ of responsibility can easily amount to a denial of authority."⁸⁷ In such a scenario, accountability can be understood to cross over the line to where a new and competing locus of authority is created—a locus of authority, such as uninformed shareholders, that does not benefit from the informational advantages of the original authority.

Accountability under statutory corporate law also has the characteristic of being intermittent. That is, shareholder involvement in corporate decision-making is the exception to the rule. It is only in the unusual situation when a fundamental change to the corporation is about to occur that directors are required to ask shareholders to participate. For example, statutory law will allow shareholders the right to have veto power over a board-approved merger agreement, but will disallow shareholders' votes in almost all other decision areas.⁸⁸ As Professor Arrow suggests, to correctly implement accountability, "it would appear that [accountability] must be intermittent. This could be periodic; it could take the form of 'management by exception,' in which authority and its decisions are reviewed only when performance is sufficiently degraded from expectations."⁸⁹ Thus, statutory corporate law, which is both light-handed and intermittent, implements a delicate balancing act between board authority and accountability, with the target point being heavily weighted toward authority.

B. *Chancellors and Judges as the Locus of Authority for Determining Shareholder Wealth Maximization*

Corporate accountability does not end with statutory corporate law. The courts and their application of fiduciary duties provide a second source of corporate accountability. If the courts overzealously apply them, these duties could potentially eviscerate the statutory approach of enabling the board to be the locus of authority for determining whether corporate decisions are shareholder wealth-maximizing. But to their credit,

84. ARROW, *supra* note 65, at 73–74.

85. *Id.* at 74.

86. *Id.* at 77–78.

87. *Id.* at 78 (emphasis added).

88. DEL. CODE ANN. tit. 8, § 251(c) (West, Westlaw through 79 Laws 2013, chs. 1–13, 19).

89. ARROW, *supra* note 65, at 78.

chancellors and judges, as previously discussed, apply both a light-handed and intermittent approach to fiduciary duties, which is an approach consistent with statutory law.

Chancellors and judges take this approach because they want directors to be the locus of corporate authority and thus those who determine whether a decision maximizes shareholder wealth. Long ago, courts realized that they do not have the business acumen to set corporate policy or objectives, and such review would only harm the efficiency of corporate decision-making. Judges recognize that they are lacking in information, decision-making skills, expertise, and interests (i.e., lacking a stake in the company) relative to corporate management. As stated by the Michigan Supreme Court in the famous case of *Dodge v. Ford Motor Co.*,⁹⁰ “[J]udges are not business experts.”⁹¹ In *Kamin v. American Express Co.*,⁹² the Supreme Court of the State of New York stated that “[t]he directors’ room rather than the courtroom is the appropriate forum for thrashing out purely business questions which will have an impact on profits, market prices, competitive situations, or tax advantages.”⁹³ Finally, in *Shlensky v. Wrigley*,⁹⁴ the Illinois Appellate Court said, regarding its dicta on the wisdom of the board decision not to install lights in Wrigley Field, “[W]e do not mean to say that we have decided that the decision of the directors was a correct one. That is beyond our jurisdiction and ability.”⁹⁵

Such statements provide a strong rationale for why corporate law has so strongly embraced the business judgment rule as a means to protect directors from injunctive relief that interferes with their decision-making, and from personal liability when honest mistakes of judgment turn out badly:

The business judgment rule, as a general matter, protects directors from liability for their decisions so long as there exist “a business decision, disinterestedness and independence, due care, good faith and no abuse of discretion and a challenged decision does not constitute fraud, illegality, ultra vires conduct or waste.” There is a presumption that directors have acted in accordance with each of these elements, and this presumption cannot be overcome unless the complaint pleads specific facts demonstrating otherwise.⁹⁶

90. 170 N.W. 668 (Mich. 1919).

91. *Id.* at 684.

92. 383 N.Y.S.2d 807 (N.Y. Sup. Ct. 1976).

93. *Id.* at 812–13.

94. 237 N.E.2d 776 (1968).

95. *Id.* at 780.

96. *Robotti & Co. ex rel. Gulfport Energy Corp. v. Liddell*, No. 3128-VCN, 2010 WL 157474, at *11 (Del. Ch. Jan. 14, 2010) (footnotes omitted) (quoting 1 STEPHEN A. RADIN ET AL.,

But most importantly, when the preconditions of the business judgment rule are met—independence, disinterestedness, and due care (the focus of a decision’s potential taint), etc.—there is no room for a review of the merits of a business decision.⁹⁷

The courts’ desire to avoid reviewing a decision for its merits is consistent with an approach of utilizing the business judgment rule to avoid reviewing a decision for shareholder wealth maximization. After all, given that the norm of corporate governance is shareholder wealth maximization, then determining whether a decision is wealth-maximizing is critical to determining whether a decision is meritorious. Hence, the business judgment rule must protect this component of corporate decision-making as well. In essence, the business judgment rule can be understood as a means to protect corporate business decisions from judicial review for shareholder wealth maximization!⁹⁸

Moreover, determining whether a business decision is shareholder wealth-maximizing is not just about plugging in a formula and calculating the result, which any computer or calculator can do. Rather, it refers to the specific formula that will be utilized by management to determine if a particular decision maximizes shareholder wealth. One can think of this in terms of a mathematical formula where the decision maker is given the responsibility of choosing the variables and estimating the coefficients of those variables. This requires many sources of knowledge and expertise that chancellors and judges lack, including experience in the particular business that the company may be in, product and company knowledge, management skills, financial skills, creative and analytical thinking pertinent to a company’s business, confidential information, and so on. For example, who has the knowledge and expertise to decide whether a distinctive corporate culture enhances or detracts from shareholder value? The clear answer is that the board and its executive management are the proper locus of authority for making this decision.

THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES FOR CORPORATE DIRECTORS 110 (6th ed. 2009)).

97. Bainbridge, *supra* note 52, at 99 (“[I]f the requisite preconditions are satisfied, there is no remaining scope for judicial review of the substantive merits of the board’s decision.”).

98. At one time, the business judgment rule was understood as an abstention doctrine in the context of prohibiting judges from reviewing corporate business decisions where the plaintiff claimed a breach in the board’s duty of care. *Id.* However, given that gross negligence can now overcome the business judgment rule and the preclusion of duty of care claims has come under the domain of exculpation clauses, the abstention doctrine embodied in the business judgment rule is now better understood to apply to the review for shareholder wealth maximization, not the duty of care. *See* Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985), *overruled on other grounds by* Gantler v. Stephens, 965 A.2d 695 (Del. 2009); *supra* note 47. This modern understanding of the business judgment rule is palatable if society accepts that the blunt preclusion of duty of care claims has historically only been a means to the end of achieving shareholder wealth maximization and that the business judgment rule still exists to achieve this ultimate objective.

In practice, chancellors and judges have simply intuited what Professor Kenneth Arrow observed regarding the efficient functioning of large organizations. That is, an increase in managerial accountability does not necessarily result in enhanced organizational decision-making.⁹⁹ Authority is the value that needs to be emphasized and protected.¹⁰⁰ As Arrow suggested, “If every decision of A is to be reviewed by B, then all we have really is a shift in the locus of authority from A to B and hence no solution to the original problem.”¹⁰¹ This statement by Professor Arrow really hits the nail on the head when it comes to the judicial review of board decisions. In essence, accountability in the form of review must be understood as the exception to the rule that the board must be the corporate decision maker.

Think about this in terms of courts significantly increasing their review of business decisions for shareholder wealth maximization. This increased review would make the courts a competing locus of authority for this determination. Such a locus of authority would have less expertise, information, and interest than the board of directors in the determination of whether a business decision maximizes shareholder wealth. The increased review by a disadvantaged locus of authority would simply lead boards to modify their shareholder wealth maximization calculus to conform to a court’s expectations (rather than its own), which would lead to suboptimal decision-making. As a result, the enhanced accountability created by this type of judicial review would lead to fewer decisions that result in shareholder wealth maximization, not more!

1. Implementing Fiduciary Duties as Tools of Accountability

Even though courts do not want the responsibility of reviewing for shareholder wealth maximization, this does not mean that the courts totally abandon the use of fiduciary duties as tools of such review. As already discussed, Professor Arrow argues that accountability in a large organization with a centralized authority requires accountability that is implemented with both a light touch and applied intermittently.¹⁰² So instead of focusing directly on shareholder wealth maximization, the courts look for other types of corporate behavior that would indicate that directors are not making decisions that maximize shareholder wealth. As already mentioned, the duty of care implicates such behavior when the directors

99. ARROW, *supra* note 65, at 73–74. It should be noted that Professor Arrow was talking in the context of large organizations, which of course include many public companies. However, this thinking would also seem to apply to small organizations as well, including close corporations such as craigslist.

100. *Id.* at 68–70.

101. *Id.* at 78.

102. *Id.* at 73–74, 78.

are not adequately informed when making a decision.¹⁰³ If the directors are shown to have acted with gross negligence in becoming informed, then a court may either enjoin the decision or find the directors liable under a fairness standard of review with burden shifting (assuming no exculpation clause is in place).¹⁰⁴ This is consistent with Professor Arrow's light-handed and intermittent approach.

The duty of loyalty is more vigorously enforced by the courts but still consistent with Professor Arrow's approach to accountability in a large organization.¹⁰⁵ As already mentioned, the fact that a decision has allegedly failed to maximize shareholder wealth does not trigger a judicial review for a breach of the directors' duty of loyalty. This shows respect for the board of directors as being the locus of authority for making this determination. However, this protection of managerial discretion is voided when a decision is either tainted or presumed tainted by a conflict of interest, a lack of independence, or both.

Yet this is not the end of the duty of loyalty inquiry. If a board breaches its duty of loyalty during corporate decision-making, then the court reviews the decision under a fairness standard with the burden of proof shifted to directors.¹⁰⁶ Thus, like a breach in the duty of care, the board gets the opportunity to show that its actions, even though tainted, are nevertheless consistent with directors striving for shareholder wealth maximization.

A fairness standard of review drops the protection of managerial discretion as corporate law's primary strategy when taint exists and puts shareholder wealth maximization directly into focus as the objective of corporate law. Still, such a standard does not require the courts to attempt to determine whether the decision under review actually maximizes shareholder wealth. Instead, the standard requires evidence from the board of directors that they were *striving* to maximize shareholder value.¹⁰⁷ For example, under an entire fairness standard of review the courts allow the board of directors to meet their burden by showing fair dealing and fair price.¹⁰⁸ Such a showing is not the same as demonstrating that the directors used the optimal process or that the transaction yielded the highest price possible, but it is enough to give directors the benefit of the doubt that they

103. See *Van Gorkom*, 488 A.2d at 873.

104. See *id.* at 872.

105. Professor Dooley suggests that while breaches of both duties represent opportunistic activity, it is socially more acceptable to punish someone for putting his interests above the corporation for personal profit (breach of the duty of loyalty) versus someone who made a flawed (grossly negligent) but honest mistake in judgment (breach of the duty of care). Dooley, *supra* note 49, at 469.

106. *Weinberger v. UOP, Inc.*, 457 A.2d 701, 710 (Del. 1983) (shifting the burden of proof to directors "to demonstrate their utmost good faith and the most scrupulous inherent fairness of the bargain" when a breach of the duty of loyalty has occurred).

107. See *id.*

108. *Id.* at 711.

were striving to maximize shareholder value. As stated by former Chancellor Allen when explaining the meaning of fair price:

A fair price does not mean the highest price financeable or the highest price that fiduciary could afford to pay. At least in the non-self-dealing context, it means a price that is one that a reasonable seller, under all of the circumstances, would regard as within a range of fair value; one that such a seller could reasonably accept.¹⁰⁹

This approach reflects the courts' understanding and wisdom that they are not in the best position for determining whether a board decision or a certain value offered or realized actually maximizes shareholder wealth, especially in hindsight.¹¹⁰ Thus, the courts must still give the board the benefit of the doubt, as the locus of authority with the best opportunity to get as close to shareholder wealth maximization as possible, so long as the board can provide evidence that it was striving for shareholder wealth maximization.

2. Market Tools of Accountability

In addition to the tools of accountability implemented by the courts, it should not be forgotten that the marketplace provides even stronger tools of accountability in the fight against agency costs.¹¹¹ These stronger tools originate in the product, financial, and labor markets, not the courtroom.¹¹² For example, assuming there exists "a high positive correlation between corporate managerial efficiency and the market price of shares of that company," then a company's low share price will indicate to management that it is not currently making shareholder wealth-maximizing decisions and that it needs to make changes.¹¹³

109. *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1134, 1143 (1994).

110. As a result of "hindsight bias," a particular outcome becomes more probable in hindsight as opposed to the same outcome made with foresight. Hal R. Arkes & Cindy A. Schipani, *Medical Malpractice v. the Business Judgment Rule: Differences in Hindsight Bias*, 73 OR. L. REV. 587, 591-92 (1994).

111. Dooley, *supra* note 49, at 525 ("The necessary conditions for accountability are supplied by competitive forces in the product market, in the internal and external markets for managers and, ultimately, in the market for corporate control.").

112. According to Stephen Bainbridge:

Corporate managers operate within a pervasive web of accountability mechanisms that substitute for monitoring by residual claimants. Important constraints are provided by a variety of market forces. The capital and product markets, the internal and external employment markets, and the market for corporate control all constrain shirking by firm agents.

Bainbridge, *supra* note 37, at 568 n.103.

113. Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110,

The importance of market tools of accountability also helps explain why the courts and corporate law make it so difficult to find directors liable for a breach of their duty of care. According to Professors Goshen and Parchomovsky:

Although courts can discern fraud or illegal transfers, they are ill-equipped to evaluate the quality of business decisions. As a result, judicial oversight can curtail breaches of the duty of loyalty but not breaches of the duty of care. . . . [T]he task of curbing breaches of the duty of care is largely left to the market and to social norms. Intense coverage by analysts . . . is the most effective antidote to management agency costs.¹¹⁴

Therefore, courts should not try to substitute their feedback for what the marketplace can provide.

IV. THE *REVLON* DUTY: THE EXCEPTION THAT IS LOSING ITS SPECIAL STATUS

For many years the *Revlon* duty was the lone exception to corporate law's strategy that judicial review will not shift to a direct focus on shareholder wealth maximization unless one of corporate law's triad of filters is present. The *Revlon* duty "requires a board, when it undertakes a sale of the company, to set its singular focus on seeking and attaining the highest value *reasonably* available to the stockholder."¹¹⁵ Under this enhanced scrutiny standard of review, the burden is on directors to demonstrate that they had this singular focus, and then the court will closely scrutinize the process by which the board settled on a price.¹¹⁶ Most importantly, by shifting the burden of proof to directors and changing the standard of review from the business judgment rule to reasonableness, *Revlon* created a presumption that the decision to sell a company was tainted.¹¹⁷ Moreover, until *Lyondell Chemical Co. v. Ryan*,¹¹⁸ there was no way a board could overcome this presumption and avoid a court-imposed reasonableness review of the sale process.¹¹⁹ However, this is no longer the

112 (1965).

114 . Zohar Goshen & Gideon Parchomovsky, *The Essential Role of Securities Regulation*, 55 DUKE L.J. 711, 717–18 (2006) (footnotes omitted).

115. Ryan v. Lyondell Chem. Co., No. 3176–VCN, 2008 WL 2923427, at *2 (Del. Ch. July 29, 2008) (emphasis added) (citing *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986), *rev'd on other grounds*, 970 A.2d 235 (Del. 2009)).

116. See *Paramount Commc'ns Inc. v. QVC Network Inc.*, 637 A.2d 34, 45 (Del. 1994).

117. See *Revlon*, 506 A.2d at 180.

118. 970 A.2d 235, 244 (Del. 2009) (shifting the trial court's inquiry to "whether th[e] directors utterly failed to attempt to obtain the best sale price").

119. However, a plaintiff still has to plead sufficient facts to overcome a motion to dismiss. See *Malpiede v. Townson*, 780 A.2d 1075, 1083–84 (Del. 2001) ("Although the *Revlon* doctrine

case at least in the context of director liability, which is a fact that may surprise many practitioners and corporate law students alike. The discussion below describes how *Lyondell* has transformed the *Revlon* duty so that it now conforms, in the context of evaluating director liability, to corporate law's traditional approach to shareholder wealth maximization.¹²⁰

To understand why the *Revlon* duty had been an outlier to corporate law's traditional approach to the review for shareholder wealth maximization for so many years, it is important to understand that it originated out of the *Unocal* test, a test that begins with the presumption that a board decision is tainted with self-interest—that is, the board is entrenched.

A. *The Unocal Test*

The *Unocal* test is a two-pronged test that the Delaware courts use to review defensive measures taken by a board of directors to repel attempts by an outside investor or group of investors to gain control of the corporation. Under the first prong, for a defensive measure to pass the test and not result in a finding that the directors breached their fiduciary duty of loyalty, the burden is on the directors to show that they had “reasonable grounds for believing that a danger to corporate policy and effectiveness existed.”¹²¹ This burden is met by reasonable investigation and a showing of good faith.¹²² Reasonable investigation requires a showing that the board was adequately informed under the gross negligence standard of review that was established in *Smith v. Van Gorkom*.¹²³ The finding of good faith requires a showing that the directors acted in response to a perceived threat to the corporation and not out of self-interest.¹²⁴ A defensive measure fails the good faith prong if it was implemented “for an inequitable purpose.”¹²⁵ Consistent with corporate law's traditional approach, evidence of good

imposes enhanced judicial scrutiny of certain transactions involving a sale of control, it does not eliminate the requirement that plaintiffs plead sufficient facts to support the underlying claims for a breach of fiduciary duties in conducting the sale.”)

120. However, the approach found in *Lyondell* for purposes of determining director liability has yet to be applied when the plaintiff seeks to enjoin a sale of the company because the defendants have allegedly violated their *Revlon* duty. Thus, a reasonableness review still exists in that context. See *In re Dollar Thrifty S'holder Litig.*, 14 A.3d 573, 575, 595 (Del. Ch. 2010); *In re Cogent, Inc. S'holder Litig.*, 7 A.3d 487, 497 (Del. Ch. 2010).

121. *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985) (emphasis added) (citing *Cheff v. Mathes*, 199 A.2d 548, 554–55 (Del. 1964)).

122. *Id.* (citing *Cheff*, 199 A.2d at 555).

123. 488 A.2d 858, 873 (Del. 1985), *overruled on other grounds by* *Gantler v. Stephens*, 965 A.2d 695 (2009).

124. See *Unocal*, 493 A.2d at 953–55.

125. *Mercier v. Inter-Tel (Del.) Inc.*, 929 A.2d 786, 807 (Del. Ch. 2007) (citing *Unocal*, 493 A.2d at 955).

faith and reasonable investigation is “materially enhanced . . . by the approval of a board comprised of a majority of outside independent directors.”¹²⁶ Under the second prong, the board must demonstrate that the measure was “reasonable in relation to the threat posed.”¹²⁷

The *Unocal* test is considered an intermediate standard of review typically referred to as “enhanced scrutiny.”¹²⁸ As a standard of review, it is situated between the business judgment rule and entire fairness.¹²⁹ The *Unocal* test can be thought of “as a ‘conditional business judgment rule.’”¹³⁰ That is, in order for the defensive measure to receive the protection of the business judgment rule, the directors must first pass the *Unocal* test. This test is necessary because directors may be conflicted and “acting primarily in [their] own interests,” such as for purposes of trying to entrench themselves in office,¹³¹ when responding to a takeover threat that is either imminent¹³² or in the future.¹³³ Therefore, the *Unocal* test adds a significant layer of accountability prior to a board receiving the protections of the business judgment rule.¹³⁴

The *Unocal* test was originated in *Unocal Corp. v. Mesa Petroleum Co.*, where the Delaware Supreme Court applied the test to a company’s self-tender offer for its own shares made in response to a two-tier front-loaded tender offer made by a hostile bidder.¹³⁵ In *Moran v. Household International, Inc.*, the Delaware Supreme Court applied the test to a rights offering that was implemented to ward off possible threats, but not an imminent threat.¹³⁶ The rights plan in *Moran*¹³⁷ is the type of defensive measure found in *eBay Domestic Holdings, Inc. v. Newmark*,¹³⁸ the case that is the major focus of this Article.¹³⁹

In a director-centric approach to corporate law, we can interpret the *Unocal* test as the courts’ acknowledgement, whether right or wrong, that the hostile takeover bid, as a market tool of accountability, moves the balance between authority and accountability too far in the direction of

126. *Unocal*, 493 A.2d at 955.

127. *Id.* (emphasis added).

128. *Reis v. Hazelett Strip-Casting Corp.*, 28 A.3d 442, 457 (Del. Ch. 2011).

129. *Id.*

130. Stephen M. Bainbridge, *Unocal at 20: Director Primacy in Corporate Takeovers*, 31 DEL. J. CORP. L. 769, 796 (2006) (quoting Dooley, *supra* note 49, at 515).

131. *Unocal*, 493 A.2d at 954.

132. *See id.*

133. *See Moran v. Household Int’l, Inc.*, 500 A.2d 1346, 1349–50 (Del. 1985) (applying the *Unocal* test to a rights offering that was adopted as a preventive measure to ward off coercive two-tier tender offers that might arise in the future).

134. *See id.* at 1357.

135. 493 A.2d at 949–51.

136. 500 A.2d at 1349–50.

137. *Id.* at 1348.

138. 16 A.3d 1 (Del. Ch. 2010).

139. *See infra* Parts V–VI.

accountability. Therefore, defensive measures have value in moving the balance back toward authority as they allow the board to take an active role¹⁴⁰ in being “the defender of the metaphorical medieval corporate bastion and the protector of the corporation’s shareholders.”¹⁴¹ However, this balancing act is not complete. Defensive measures can result in erroneous corporate decision-making if the board implements them for purposes of entrenchment. Former Chancellor Chandler describes the entrenchment issue in the context of a poison pill as follows:

The Rights Plan, on the other hand, implicates *Unocal* concerns in my view because rights plans (known as “poison pills” in takeover parlance) fundamentally are defensive devices that, if used correctly, can enhance stockholder value but, if used incorrectly, can *entrench* management and deter value-maximizing bidders at the stockholders’ expense.¹⁴²

This awareness of entrenchment has created a presumption that directors have a conflict of interest whenever they implement defensive measures. As stated by the court in *Unocal*: “Because of the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders, there is an enhanced duty which calls for judicial examination at the threshold before the protections of the business judgment rule may be conferred.”¹⁴³ This presumption is evidenced by the court taking the extraordinary measure of putting the burden of proof on the board to show that it has met both prongs of the *Unocal* test.¹⁴⁴ Such burden shifting is an acknowledgement that the board atmosphere is extremely ripe for error in decision-making as a result of the tendency for entrenchment. This requires the standard of review to be a tool of accountability that goes beyond what the business judgment rule requires.

B. *The Unocal Test and the Revlon Duty*

The *Revlon* duty made its debut in a case where a board of directors took defensive measures to ward off a hostile bidder, and the Delaware Supreme Court initially reviewed the measures under the *Unocal* test.¹⁴⁵ However, during the merger process, the court found that the deal protection measures inserted into a merger agreement with a white knight

140. See *Unocal*, 493 A.2d at 954 (“[A] board of directors is not a passive instrumentality.”).

141. *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1388 (Del. 1995).

142. *eBay*, 16 A.3d at 28 (emphasis added).

143. *Unocal*, 493 A.2d at 954.

144. See Dooley, *supra* note 49, at 516 (“Placing this initial burden of justification on the board is truly extraordinary and demonstrates clear recognition that the board’s resistance may have been selfishly motivated.” (citing *Unocal*, 493 A.2d at 954)).

145. *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 180 (Del. 1986).

could not be reviewed under *Unocal*, and that a new standard of review was triggered when it became clear to the board that the break-up of the company was inevitable:

The duty of the board had thus changed from the preservation of Revlon as a corporate entity to the maximization of the company's value at a sale for the stockholders' benefit. This significantly altered the board's responsibilities under the *Unocal* standards. It no longer faced threats to corporate policy and effectiveness, or to the stockholders' interests, from a grossly inadequate bid. The whole question of defensive measures became moot. The directors' role changed from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company.¹⁴⁶

The focus of the court then shifted. Instead of requiring the board to demonstrate that the defensive measures implemented were not for the primary purpose of entrenchment, the court required the board to show that it only had the interests of shareholders in mind, and not any other stakeholder group¹⁴⁷ or themselves,¹⁴⁸ when implementing deal protection measures in an agreement to sell the company.¹⁴⁹

The *Revlon* duty¹⁵⁰ is the tool of accountability, and shareholder wealth

146. *Id.* at 182.

147. The court described the board's new good faith obligation when admonishing the Revlon directors for taking into consideration the interests of another stakeholder group, the noteholders, when determining which bidder should have the opportunity to buy the company:

The original threat posed by Pantry Pride—the break-up of the company—had become a reality which even the directors embraced. Selective dealing to fend off a hostile but determined bidder was no longer a proper objective. Instead, obtaining the highest price for the benefit of the stockholders should have been the central theme guiding director action. Thus, the Revlon board could not make the *requisite showing of good faith* by preferring the noteholders and ignoring its duty of loyalty to the shareholders. The rights of the former already were fixed by contract. The noteholders required no further protection, and when the Revlon board entered into an auction-ending lock-up agreement with Forstmann on the basis of impermissible considerations at the expense of the shareholders, the directors breached their primary duty of loyalty.

Id. at 182 (emphasis added) (citations omitted).

148. The principal benefit of preferring the noteholders went to the directors, who avoided the possibility of facing the potential of personal liability as a result of a lawsuit filed by the noteholders. *Id.* at 184.

149. The primary deal protection measure refers to a lock-up agreement with the Revlon board's white knight, Mr. Forstmann. *Id.* at 178, 182.

150. Other scenarios where the *Revlon* duty kicks in include “where, in response to a bidder's offer, a target abandons its long-term strategy and seeks an alternative transaction involving the

maximization is the objective of that tool in this final period of decision-making.¹⁵¹ It represents the application of a board's fiduciary duties of care and loyalty in the context of unique and narrowly-defined circumstances.¹⁵² That is, "the 'board must perform its fiduciary duties in the service of a specific objective: maximizing the sale price of the enterprise.'"¹⁵³

Significantly, the court's enhanced scrutiny analysis focused on whether the board's actions were adequate and reasonable, not whether the board actually obtained "the highest value reasonably available to the stockholders."¹⁵⁴ As the Delaware Supreme Court described in *Paramount Communications Inc. v. QVC Network Inc.*,¹⁵⁵ enhanced scrutiny has the following features:

The key features of an enhanced scrutiny test are: (a) a judicial determination regarding the adequacy of the decisionmaking process employed by the directors, including the information on which the directors based their decision; and (b) a judicial examination of the reasonableness of the directors' action in light of the circumstances then existing. The directors have the burden of proving that they were

break-up of the company,"¹⁵¹ *Arnold v. Soc'y for Sav. Bancorp, Inc.*, 650 A.2d 1270, 1290 (Del. 1994) (quoting *Paramount Commc'ns, Inc. v. Time Inc.*, 571 A.2d 1140, 1150 (Del. 1990)), and when a board begins to negotiate a transaction that *may* result in a sale or change of control. *Lyondell Chem. Co. v. Ryan*, 970 A.2d 235, 242 (Del. 2009) ("The time for action under *Revlon* did not begin until July 10, 2007, when the directors began negotiating the sale of Lyondell."). "In the latter situation, there is no 'sale or change of control' when '[c]ontrol of both [companies] remain[s] in a large, fluid, changeable and changing market.'" *Arnold*, 650 A.2d at 1290 (alterations in original) (quoting *Paramount Commc'ns, Inc. v. QVC Network, Inc.*, 637 A.2d 34, 45, 47 (Del. 1994)).

151. A board may be willing to sell control of the company for a variety of reasons. It may be offered such a premium over its current stock price that it may feel compelled to sell to satisfy the interests of its shareholders. It may acknowledge that a different management group may be able to manage the organization more efficiently. Or perhaps it may recognize that a new management team under the direction of a control group may be less inhibited in breaching long-term agreements with certain stakeholders that long ago outlived their usefulness to the organization. See Andrei Shleifer & Lawrence H. Summers, *Breach of Trust in Hostile Takeovers*, in *CORPORATE TAKEOVERS: CAUSES AND CONSEQUENCES* 33, 33 (Alan J. Auerbach ed., 1988) (noting that shareholders may receive a large premium because of "improved management" or "increased efficiency" (citing Michael C. Jensen, *Takeovers: Folklore and Science*, HARV. BUS. REV., Nov.-Dec. 1984, at 109-21)); *id.* at 37-52 (arguing that the breach of long-term agreements after a takeover contributes to the premium received by shareholders). As the ultimate decision-making authority in the corporation, the board has the right to enter into these transactions for the benefit of shareholders.

152. See *Lyondell*, 970 A.2d at 239.

153. *Id.* (quoting *Malpiede v. Townson*, 780 A.2d 1075, 1083 (Del. 2001)).

154. *Ryan v. Lyondell Chem. Co.*, No. 3176-VCN, 2008 WL 2923427, at *2 (Del. Ch. July 29, 2008) (citing *Revlon*, 506 A.2d at 182), *rev'd*, 970 A.2d 235.

155. 637 A.2d 34 (Del. 1994).

adequately informed and acted reasonably.¹⁵⁶

Therefore, “courts will not substitute their business judgment for that of the directors, but will determine if the directors’ *decision* was, on balance, within a range of reasonableness.”¹⁵⁷ Again, the courts are looking for evidence that the board was *striving* for shareholder wealth maximization, not that it actually achieved it.

Even so, given that reasonable minds may differ on what “the highest value *reasonably* available to the stockholder”¹⁵⁸ may actually mean, the *Revlon* duty appeared to create significant uncertainty and considerable potential liability for a board of directors. Most significantly, there was no way for a board to escape a reasonableness review for shareholder wealth maximization even in the absence of the courts’ triad of filters: gross negligence, lack of independence, and interestedness. *Lyondell* partially corrected this.

In *Lyondell*, the plaintiffs sought damages from the Lyondell Chemical Co.’s board of directors for allegedly breaching their duty of loyalty by failing to act in good faith when performing their *Revlon* duty.¹⁵⁹ In finding for the directors, the court methodically resurrected the traditional safe harbor for director liability. First, the court noted that Lyondell Chemical Co.’s charter included an exculpatory clause that eliminated any duty of care claims from judicial review.¹⁶⁰ Second, all eleven members of the board were independent¹⁶¹ except for the chairman who was also the chief executive officer.¹⁶² Moreover, there was no evidence that the independent directors were improperly interested¹⁶³ or acted with ill will.¹⁶⁴ In sum, a board that was exculpated from duty of care liability, disinterested, and independent meant that the plaintiffs could only seek relief based on the

156. *Id.* at 45.

157. *Id.* (emphasis added).

158. *Lyondell*, 2008 WL 2923427, at *2 (emphasis added) (citing *Revlon*, 506 A.2d at 182).

159. 970 A.2d at 239.

160. *Id.*

161. Under Delaware law, a court determines whether a director is independent by asking “whether a director, although lacking in a financial self-interest, is somehow ‘beholden’ to an individual who is interested, or whose decisions are not based on the corporate merits, but rather are influenced by ‘personal or extraneous considerations.’” Usha Rodrigues, *The Fetishization of Independence*, 33 J. CORP. L. 447, 466 (2008) (quoting *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 362 (Del. 1993)).

162. *Lyondell*, 2008 WL 2923427, at *4.

163. Under Delaware law, “[a] director is interested in a given transaction if she stands to gain monetarily from it in a way that other shareholders do not.” Rodrigues, *supra* note 161, at 466 (citing *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984), *overruled on other grounds by Brehm v. Eisner*, 746 A.2d 244, 254 (2000)).

164. *Lyondell*, 970 A.2d at 239–40; *Lyondell*, 2008 WL 2923427, at *10.

sole claim that the board “breached their duty of loyalty by failing to act in good faith.”¹⁶⁵

For purposes of the *Lyondell* decision, failing to act in good faith is equivalent to acting in bad faith.¹⁶⁶ In terms of what is meant by acting in bad faith¹⁶⁷ the *Lyondell* court applied the rule that “bad faith will be found if a ‘fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties.’”¹⁶⁸ This meant that “[o]nly if [the board] knowingly and completely failed to undertake their responsibilities would they breach their duty of loyalty.”¹⁶⁹ Moreover, “there are no legally prescribed steps that directors must follow to satisfy their *Revlon* duties.”¹⁷⁰ “Thus, the directors’ failure to take any *specific* steps during the sale process could not have demonstrated a conscious disregard of their duties.”¹⁷¹ The result is that the court and the board may be able to avoid a reasonableness review for shareholder wealth maximization even under the *Revlon* duty.

Fortunately, *Lyondell* has eliminated, in the context of the *Revlon* duty, the requirement for a reasonableness review when the traditional triad of filters are not present and director liability is at issue. Hopefully, courts will subsequently apply the *Lyondell* approach when a shareholder attempts to use the *Revlon* duty to enjoin a transaction. Unfortunately, the lesson learned in *Lyondell* seems to have been ignored in *eBay*.

V. *eBAY DOMESTIC HOLDINGS, INC. v. NEWMARK*

In *eBay*, former Chancellor Chandler reviewed the legality of a shareholder rights offering (the Rights Plan) approved by the board of directors of craigslist, Inc. (craigslist), a close corporation with a control group that consisted of shareholders Craig Newmark (Newmark) and James Buckmaster (Buckmaster).¹⁷² The case was initiated by eBay

165. *Lyondell*, 970 A.2d at 239–40.

166. *Id.* at 240 n.8.

167. While not at issue in *Lyondell*, directors, even if not self-interested, could also have failed to act in good faith by considering the interests of other stakeholders when under their *Revlon* duty. See *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986) (“[T]he *Revlon* board could not make the requisite showing of good faith by preferring the noteholders and ignoring its duty of loyalty to the shareholders.”).

168. *Lyondell*, 970 A.2d at 243 (quoting *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 67 (Del. 2006)).

169. *Id.* at 243–44.

170. *Id.* at 243.

171. *Id.* (emphasis added).

172. *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1, 6, 11 (Del. Ch. 2010). Newmark owned 42.6%, Buckmaster 29%, and eBay Domestic Holdings, Inc. 28.4% of craigslist. A voting agreement between Newmark and Buckmaster provided them with control of craigslist. *Id.* at 11, 13. Specifically, the voting agreement required Newmark and Buckmaster to vote their shares so as to elect one board member designated by Newmark and one board member designated by Buckmaster. *Id.* at 13. Since a stock purchase agreement between Newmark, Buckmaster, and eBay

Domestic Holdings, Inc. (eBay), a wholly owned subsidiary of eBay, Inc. and the only other shareholder besides Newmark and Buckmaster.¹⁷³ Newmark and Buckmaster served as two of the three members of the company's board of directors.¹⁷⁴

Besides challenging the legality of the Rights Plan, eBay also challenged the legality of two other corporate actions, the implementation of a staggered board and a plan "to obtain a right of first refusal in craigslist's favor over the craigslist shares eBay owns."¹⁷⁵ However, only the Rights Plan implicated shareholder wealth maximization, which is the focus of this Article.

The Rights Plan worked as follows:

The Rights Plan pays a dividend to craigslist stockholders of one right per share of craigslist stock. Each right allows its holder to purchase two shares of craigslist stock at \$0.00005 per share if the rights are triggered. There are two triggers. The first trigger involves acquisitions by Jim, Craig, or eBay. If any of these three becomes the "Beneficial Owner" of 0.01% of additional craigslist stock, the rights are triggered. The second trigger involves anyone other than Jim, Craig, or eBay. Should any such person become the "Beneficial Owner" of 15% or more of craigslist's outstanding shares, the rights are triggered.¹⁷⁶

The effect of the Rights Plan "restricted eBay from purchasing additional craigslist shares and hampered eBay's ability to freely sell the craigslist shares it owned to third parties."¹⁷⁷ The court held that Newmark and Buckmaster had violated their fiduciary duties as directors by adopting the Rights Plan, and ordered it rescinded.¹⁷⁸

A. eBay and the Unocal Test

The Chancery Court reviewed the Rights Plan under the *Unocal* test, which is the standard test for reviewing defensive measures.¹⁷⁹ The court's use of this test is somewhat controversial because of the unique set of

Domestic Holdings, Inc. required the craigslist charter to have a three member board of directors, Newmark and Buckmaster as a group had control of the company. *See id.* at 11.

173. *Id.* at 6–7, 11.

174. *Id.* at 13.

175. *Id.* at 6.

176. *Id.* at 23.

177. *Id.* at 6.

178. *Id.* at 35.

179. *Id.* at 28 ("The Rights Plan . . . implicates *Unocal* concerns . . . because rights plans . . . fundamentally are defensive devices that, if used correctly, can enhance stockholder value but, if used incorrectly, can entrench management and deter value-maximizing bidders at the stockholders' expense.").

circumstances in which the board implemented the Rights Plan. As the court noted, up to that point there were many cases that involved the review of rights plans in the context of public companies, not private companies such as craigslist.¹⁸⁰ Additionally, it is a rarity for a private company to even implement a rights plan.¹⁸¹ This is so because when an unsolicited takeover attempt occurs, the typically small number of shareholders of the company would not want to give up the power to negotiate the sale of their shares to the board of directors.¹⁸² Moreover, the board did not initiate the Rights Plan for entrenchment purposes—since Newmark and Buckmaster controlled the company through a voting agreement and by making up a majority of the board—or to keep these shareholders from considering a premium price for their shares.¹⁸³ Looming over all of these facts were the allegations that eBay used craigslist’s nonpublic information to compete with craigslist.¹⁸⁴

Given the facts of *eBay*, Professor D. Gordon Smith suggests that it may be more appropriate to describe *eBay* as a case of minority oppression.¹⁸⁵ If so, then a more appropriate standard of review may have been entire fairness or possibly “reasonable expectations” as established in *Litle v. Waters*.¹⁸⁶ Nevertheless, the court in *eBay* utilized the *Unocal* test as the standard of review. What is most significant about this application was that former Chancellor Chandler identified *shareholder wealth maximization* as the objective guiding the first prong of the *Unocal* test.¹⁸⁷ More specifically, for directors to meet their burden of proof under the first prong of the *Unocal* test, they must show that the corporate policy they are trying to defend enhanced shareholder value under *Unocal*’s

180. *Id.* at 30–31, 30 n.95.

181. *Id.* (citing LOU R. KLING & EILEEN T. NUGENT, NEGOTIATED ACQUISITIONS OF COMPANIES, SUBSIDIARIES AND DIVISIONS § 16.06 n.1 (2010)).

182. *Id.* at 30 n.95 (citing LOU R. KLING & EILEEN T. NUGENT, NEGOTIATED ACQUISITIONS OF COMPANIES, SUBSIDIARIES AND DIVISIONS § 16.06 n.1 (2010)).

183. *Id.* at 31.

184. *Id.* at 17.

185. See Gordon Smith, *eBay v. Newmark: A Modern Version of Dodge v. Ford Motor Company*, CONGLOMERATE (Sept. 9, 2010), <http://www.theconglomerate.org/2010/09/ebay-v-newmark-a-modern-version-of-dodge-v-ford-motor-company.html>. Minority shareholder oppression, in the form of a “squeeze out” of the minority shareholder from the operations and management of the company, or the “freeze out” of the minority shareholder in his ability to sell or cash-out his shares in the company, can arise in the scenario where the minority shareholder has a limited ability to sell his shares either because of a lack of public market or because of restrictions placed on the sale of his shares by a shareholder agreement. See Ladd A. Hirsch & James D. Sheppard, Claims for Oppression by Minority Shareholders in Private Companies Under Texas and Delaware Law: A Plaintiff’s Perspective 2 (Feb. 10, 2012) (presented at 2012 Securities Regulation and Business Law Conference), available at http://www.diamondmccarthy.com/files/utcle_hirsch_article_for_utcle_2012_securities_reg_and_bus_conf_law_the_rights_and_remedies_of_oppressed_minority_shareholders_in_private_companies_copy1.pdf.

186. No. 12155, 1992 WL 25758, at *327–28 (Del. Ch. Feb. 11, 1992).

187. *eBay*, 16 A.3d at 35.

reasonableness standard of review.¹⁸⁸ If the board of directors in *eBay* could not do this, then the Rights Plan could not be justified.

Consistent with *Moran*, former Chancellor Chandler applied the *Unocal* test to the craigslist Rights Plan in the following manner: “First, did Jim and Craig properly and reasonably perceive a threat to craigslist’s corporate policy and effectiveness? Second, if they did, is the Rights Plan a proportional response to that threat?”¹⁸⁹

In regard to the first prong of the *Unocal* test, Newmark and Buckmaster argued that the Rights Plan was necessitated by the alleged threat to craigslist’s corporate culture that would follow their deaths and to the distribution of their shares to their heirs.¹⁹⁰ They speculated that their heirs would sell their shares to eBay and thereby give eBay control of the company.¹⁹¹ At that point, eBay would no doubt alter the company’s values, culture, and business model away from their “public-service mission” to one where the objective would be maximizing the company’s profits.¹⁹²

However, the court found that Newmark and Buckmaster “did *not* adopt the Rights Plan in response to a reasonably perceived threat or for a proper corporate purpose.”¹⁹³ The court’s holding was based on its determination that the craigslist culture did not enhance shareholder value and therefore was not worthy of being protected by a defensive measure.¹⁹⁴ According to the court:

Ultimately, defendants failed to prove that craigslist possesses a palpable, distinctive, and advantageous culture that sufficiently promotes stockholder value to support the indefinite implementation of a poison pill. Jim and Craig did not make any serious attempt to prove that the craigslist culture, which rejects any attempt to further monetize its services, translates into increased profitability for stockholders.¹⁹⁵

The Rights Plan failed the first prong of the *Unocal* test and therefore the court felt justified in rescinding it.¹⁹⁶ The Rights Plan also failed the second prong of the *Unocal* test, the proportionality test, because the court found that the defensive measure simply did not have a connection to the

188. *Id.* at 33.

189. *Id.* at 31–32.

190. *Id.* at 32.

191. *Id.*

192. *Id.*

193. *Id.*

194. *Id.* at 33.

195. *Id.*

196. *Id.* at 35.

protection of craigslist’s culture and was only meant to punish eBay.¹⁹⁷

B. A New Requirement

Former Chancellor Chandler’s application of the *Unocal* test begins by skeptically looking at corporate culture as being worthy of a defensive measure:

It is true that on the unique facts of a particular case—*Paramount Communications, Inc. v. Time Inc.*¹⁹⁸—this Court and the Delaware Supreme Court accepted defensive action by the directors of a Delaware corporation as a good faith effort to protect a specific corporate culture. It was a *muted embrace*.¹⁹⁹

The corporate culture that former Chancellor Chandler was referring to was Time’s “journalistic integrity,”²⁰⁰ and it was a “muted embrace” because of the very skeptical dicta that former Chancellor William Allen provided in the underlying Chancery Court case. Chancellor Allen wrote only that he was “not persuaded that there may not be instances in which the law might recognize as valid a perceived threat to a ‘corporate culture’ that is shown to be palpable (for lack of a better word), distinctive and advantageous.”²⁰¹

197. *Id.*; see also David A. Wishnick, Comment, *Corporate Purposes in a Free Enterprise System: A Comment on eBay v. Newmark*, 121 YALE L.J. 2405, 2418 (2012) (discussing how the Rights Plan failed the second prong of the *Unocal* test).

198. 571 A.2d 1140 (Del. 1990).

199. *eBay*, 16 A.3d at 32 (emphasis added). It should be noted that the court in *Unocal* provided a noninclusive laundry list of diverse concerns that could warrant a defensive measure that included “inadequacy of the price offered, nature and timing of the offer, questions of illegality, the impact on ‘constituencies’ other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally), the risk of nonconsummation, and the quality of securities being offered in the exchange.” *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985).

200. *Paramount*, 571 A.2d at 1144.

201. *Paramount Commc’ns, Inc. v. Time Inc.*, Nos. 10866, 10670, & 10935, 1989 WL 79880, at *4 (Del. Ch. July 14, 1989), *aff’d*, 571 A.2d 1140 (Del. 1989). Chancellor Allen’s complete dicta on corporate culture is as follows:

I note parenthetically that plaintiffs in this suit dismiss this claim of “culture” as being nothing more than a desire to perpetuate or entrench existing management disguised in a pompous, highfalutin’ claim. I understand the argument and recognize the risk of cheap deception that would be entailed in a broad and indiscriminate recognition of “corporate culture” as a valid interest that would justify a board in taking steps to defeat a non-coercive tender offer. Every reconfiguration of assets, every fundamental threat to the status quo, represents a threat to an existing corporate culture. But I am not persuaded that there may not be instances in which the law might recognize as valid a perceived threat to a “corporate culture” that is shown to be palpable (for lack of a better word),

Consistent with former Chancellor Allen's dicta in *Paramount*, former Chancellor Chandler did not outright reject the craigslist corporate culture as being worthy of a defensive measure.²⁰² Instead, he created an additional *Unocal* filter by reviewing the craigslist corporate culture for shareholder wealth maximization under a reasonableness standard of review consistent with *Revlon*.²⁰³

C. *The Unocal Test as a Conditional Business Judgment Rule*

Unfortunately, this *Revlon* approach is a violation of what the *Unocal* test is all about. Writing well before *eBay*, Professor Michael Dooley noted that the *Unocal* test had nothing to do with shareholder wealth maximization and everything to do with evaluating *the motives* of the board in implementing defensive measures: "[T]he *Unocal* 'reasonableness' test is intended to function as a filter for conflicted interest, rather than as an objective measure of whether the board's action was reasonably calculated to maximize shareholder wealth."²⁰⁴ According to the Delaware Chancery Court in *Mercier v. Inter-Tel (Del.), Inc.*:

[T]he burden should be on the . . . board as an initial matter to identify a legitimate corporate objective served by its decision As part of meeting that burden, the directors should bear the burden of persuasion to show that their *motivations* were proper and not selfish. That showing, however, is not sufficient to ultimately prevail. To ultimately succeed, the directors must show that their actions were reasonable in relation to their legitimate objective, and did not preclude the stockholders from exercising their right to vote or coerce them into voting a particular way. If for some reason, the fit between means and end is not reasonable, the

distinctive and advantageous.

Id.

It should be noted that whatever former Chancellor Allen thought of corporate culture back in the 1980s, recent research by managerial scholars suggests that corporate culture can be a very valuable corporate asset, perhaps the most valuable "strategic asset" that a company can have to maintain a competitive advantage. See Eric G. Flamholtz & Yvonne Randle, *Corporate Culture, Business Models, Competitive Advantage, Strategic Assets and the Bottom Line: Theoretical and Measurement Issues*, 16 J. HUMAN RESOURCE COSTING & ACCT. 76, 76–77 (2012); Eric Flamholtz, *Corporate Culture and the Bottom Line*, 19 EUR. MGT. J. 268, 268, 273 (2001); Eric Van den Steen, *Culture Clash: The Costs and Benefits of Homogeneity*, 56 MGT. SCI. 1718, 1718 (2010). See generally Eric G. Flamholtz, *Conceptualizing and Measuring the Economic Value of Human Capital of the Third Kind: Corporate Culture*, 9 J. HUMAN RESOURCE COSTING & ACCT. 78 (2005).

202. *eBay*, 16 A.3d 1 at 33.

203. *Id.*

204. Dooley, *supra* note 49, at 521; see also Bainbridge, *supra* note 130, at 829–42 (discussing the motive analysis of board action under *Unocal*).

directors would also come up short.²⁰⁵

Very simply, if directors can meet their burden of proof under the two-prong test, then the business judgment rule applies.²⁰⁶ If so, then plaintiffs can only overcome the business judgment rule that protects the directors' decision to implement the defensive measure by demonstrating that one of the triad of filters is present.²⁰⁷ If plaintiffs can do this, then an entire fairness standard of review is required,²⁰⁸ and shareholder wealth maximization becomes the focus of the court.²⁰⁹ As such, the *Unocal* test can be understood as a "conditional business judgment rule."²¹⁰ The rule is conditional in the sense that the board's decision to implement a defensive measure is provided the opportunity to be brought back under the business judgment rule, a rule where the protection of managerial discretion is the accepted strategy for achieving shareholder wealth maximization.²¹¹

D. *The Link*

If the *Unocal* test is a conditional business judgment rule, then why would former Chancellor Chandler create the Link²¹² and thereby violate corporate law's traditional approach to the *Unocal* test as well as the judiciary's traditional desire to avoid a review for shareholder wealth maximization prior to the application of its establish triad of filters?²¹³ To

205. 929 A.2d 786, 810–11 (Del. Ch. 2007) (emphasis added). Professor Sean Griffith cites *Mercier* and argues that the essential elements of enhanced scrutiny are not threat and proportionality, but motive and means. Sean J. Griffith, *The Omnipresent Specter of Omnicare*, 38 J. CORP. L. 753, 788, 788 n.241 (2013).

206. See Bainbridge, *supra* note 130, at 800 (citing *Shamrock Holdings, Inc. v. Polaroid Corp.*, 559 A.2d 257, 271 (Del. Ch. 1989)).

207. See *id.* at 822.

208. *Id.* at 800 (citing *Shamrock*, 559 A.2d at 271).

209. *Id.* at 822.

210. *Id.* at 796 (quoting Dooley, *supra* note 49, at 515) (internal quotation marks omitted).

211. See *id.* at 800.

212. See *supra* notes 12–14 and accompanying text.

213. Remember, Buckmaster and Newmark had formed a controlling group through a voting agreement and therefore it was already demonstrated that they were not primarily acting for purposes of entrenchment. *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1, 31 (Del. Ch. 2010). Thus, they had already satisfied their good faith burden under the first prong of the *Unocal* test. This meant there was essentially no conflict-of-interest filter under this prong except for reasonable investigation, which is a relatively light burden for the directors to bear. For example, the court in *Versata Enterprises, Inc. v. Selectica, Inc.* found that the board of Selectica had undertaken a reasonable investigation in determining whether Net Operating Loss (NOL) carryovers were an asset worth protecting by utilizing an old report valuing the NOL carryovers and soliciting advice from financial experts regarding their value:

The record reflects that the Selectica Board met for more than two and a half hours on November 16. The Court of Chancery heard testimony from all four

begin forming the answer, it is critical to note that former Chancellor Chandler did not need to use the Link to conclude that craigslist had failed the first prong of the *Unocal* test. This is because he found that craigslist did not have a “distinctive” corporate culture that needed protecting.²¹⁴ Rather, it just had a sales strategy that emphasized giving away free services.²¹⁵

Based on former Chancellor Allen’s dicta, a failure to demonstrate a distinctive corporate culture should have been enough to fail the first prong of the *Unocal* test.²¹⁶ Moreover, former Chancellor Chandler also found that the Rights Plan failed the proportionality test in the second prong of the *Unocal* test because the Rights Plan simply did not have a connection to the protection of the craigslist culture and was only meant to punish eBay for competing with craigslist.²¹⁷ Nevertheless, even though it was clearly unnecessary, former Chancellor Chandler still felt compelled, through the application of the Link, to convey the point that a board of directors cannot implement a defensive measure if it does not make shareholder wealth maximization the objective of the alleged corporate interest.²¹⁸

Perhaps former Chancellor Chandler implemented the Link because of the apparent disregard that Buckmaster and Newmark had for shareholder wealth maximization—a disregard that compelled former Chancellor Chandler to react. According to the former Chancellor, “Jim and Craig did prove that they personally believe craigslist should not be about the business of stockholder wealth maximization, now or in the future.”²¹⁹ Given this challenge to the purpose of for-profit corporations where minority shareholders exist, the former Chancellor may have felt obliged to

directors and from Brogan, Reilly, and Heaps, who also attended that meeting and advised the Board. The record shows that the Board first analyzed the NOLs in September 2006, and sought updated Section 382 analyses from Brogan in March 2007, June 2007, and July 2008. At the November 16 meeting, Brogan advised the Board that the NOLs were a “significant asset” based on his recently updated calculations of the NOLs’ magnitude. Reilly, an investment banker, similarly advised the Board that the NOLs were worth protecting given the possibility of a sale of Selectica or its assets. Accordingly, the record supports the Court of Chancery’s factual finding that the Board acted in good faith reliance on the advice of experts in concluding that the NOLs were an asset worth protecting and thus, that their preservation was an important corporate objective.

Versata Enterprises, Inc. v. Selectica, Inc., 5 A.3d 586, 600 (Del. 2010) (footnote omitted) (internal quotation marks omitted).

214. *eBay*, 16 A.3d at 33.

215. *Id.*

216. *See supra* note 201 and accompanying text.

217. *eBay*, 16 A.3d at 35; *see also* Wishnick, *supra* note 197, at 2418 (discussing how the Rights Plan failed the second prong of the *Unocal* test).

218. *See eBay*, 16 A.3d at 35.

219. *Id.* at 34.

punish Buckmaster and Newmark for not openly confessing their desire for shareholder wealth maximization and hiding behind the claim of protecting corporate culture when they really intended to hurt eBay. As stated by former Chancellor Chandler:

Directors of a for-profit Delaware corporation cannot deploy *a rights plan* to defend a business strategy that *openly eschews* stockholder wealth maximization—at least not consistently with the directors’ fiduciary duties under Delaware law.²²⁰

The implementation of the Link under these unique set of facts is most reminiscent of what occurred in the famous case of *Dodge v. Ford Motor Co.*,²²¹ where Henry Ford made inflammatory statements to the effect that he did not care about shareholders or making money.²²² These statements led the Michigan Supreme Court to require the board of Ford Motor Co. to declare and payout a special dividend against the wishes of Henry Ford, the controlling shareholder.²²³ Of course, what people may publicly profess to believe may not even come close to matching the objective facts. At the time the Dodge brothers filed the suit in 1916, Ford Motor Co. was incredibly profitable; it had increased annual profits from \$4,521,509.51 in 1910 to \$59,994,918.01 in 1916.²²⁴ These facts bear a resemblance to craigslist’s financial picture, even though the company does not make public its annual revenues and profits. However, according to the AIM Group, a private consulting firm specializing in classified advertising, craigslist earned an estimated \$88 million to \$99 million in profits on \$122 million of revenue in 2010, up from estimated revenues of \$100 million in 2009.²²⁵ Revenue per employee was a very impressive \$4 million with

220. *Id.* at 35 (emphasis added).

221. 170 N.W. 668 (Mich. 1919).

222. *See id.* at 683–84. According to the Michigan Supreme Court:

The record, and especially the testimony of Mr. Ford, convinces that he has to some extent the attitude towards shareholders of one who has dispensed and distributed to them large gains and that they should be content to take what he chooses to give. His testimony creates the impression, also, that he thinks the Ford Motor Company has made too much money, has had too large profits, and that, although large profits might be still earned, a sharing of them with the public, by reducing the price of the output of the company, ought to be undertaken.

Id.

223. *See id.* at 685 (affirming the lower court’s order for a special dividend).

224. *Id.* at 670 (“Sales and profits for several years were: Year ending Sept. 30, 1910, . . . \$4,521,509.51. . . . Three years endings July 31, 1916, . . . \$59,994,918.01.”).

225. Peter M. Zollman, *Craigslist Profits, Revenues Soar*, AIM GRP. (Apr. 30, 2010), <http://aimgroup.com/2010/04/30/craigslist-revenue-profits-soar>.

profits of \$2.9 million to \$3.2 million per employee.²²⁶ Tellingly, while scholars often cite *Dodge v. Ford Motor Co.* in academic literature to demonstrate the primacy of shareholder wealth maximization as the objective of corporate law, courts very rarely use it as judicial precedent.²²⁷ As this Article explains below, *eBay* hopefully will follow the same fate.

VI. THE IMPACT OF *EBAY*

The impact of *eBay* may bear witness to the old adage that bad facts create bad law. The Link has added an additional hurdle for the board of directors to satisfy in order to show that they acted in good faith under the first prong of the *Unocal* test. A showing that the board acted in good faith now means that directors must demonstrate not only that they did not implement defensive measures primarily for entrenchment purposes, but also that the corporate policy in question enhances shareholder value under a reasonableness standard of review.²²⁸ This extra burden appears to lead the *Unocal* test to where former Chancellor William Allen warned it should not go:

Delaware courts have employed the *Unocal* precedent cautiously. The promise of that innovation is the promise of a more realistic, flexible and, ultimately, more responsible corporation law. The danger that it poses is, of course, that courts—in exercising some element of substantive judgment—will too readily seek to assert *the primacy of their own view on a question upon which reasonable, completely disinterested minds might differ*. Thus, *inartfully* applied, the *Unocal* form of analysis could permit an unraveling of the well-made fabric of the business judgment rule in this important context. Accordingly, whenever, as in this case, this court is required to apply the *Unocal* form of review, it should do so cautiously, with a clear appreciation for the risks and

226. *Id.*

227. Based on a Shepard's® search dated November 15, 2013, *Dodge v. Ford Motor Co.* has only been cited by federal and state courts a total of 68 times. Citing Decisions for *Dodge v. Ford Motor Co.*, LEXIS ADVANCE, <http://advance.lexis.com> (subscription required) (perform Shepard's® search for “170 N.W. 668”) (last visited Nov. 15, 2013). More tellingly, it has only been cited by the Delaware courts three times. Citing Decisions for *Dodge v. Ford Motor Co.* by Delaware Courts, LEXIS ADVANCE, <http://advance.lexis.com/> (subscription required) (perform Shepard's® search for “170 N.W. 668”; follow “Delaware” under “State Courts” listed to left) (last visited Nov. 15, 2013).

228. According to former Chancellor Chandler, “In the typical scenario, the decision to deploy a rights plan will fall within the range of reasonableness if the directors use the plan in a good faith effort to promote stockholder value.” *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1, 28 (Del. Ch. 2010).

special responsibility this approach entails.²²⁹

The result of *eBay* is clear. If *eBay* is followed, the *Unocal* test is no longer a conditional business judgment rule. More importantly, the court has expanded its role in reviewing corporate business decisions for shareholder wealth maximization—a role the court has traditionally tried to avoid in order to maximize the efficiency of corporate decision-making. In addition, the heightened burden the Link created is really the judiciary's indirect attack on the business judgment that led to the board's implementation of the corporate policy being defended. That is, the court is taking upon itself the role of reviewing the legitimacy of corporate policy that was a result of a decision already made under the protection of the business judgment rule.

For example, what if craigslist had a corporate culture that would pass muster under former Chancellor Allen's skeptical eye? Such a review puts the corporate policy at risk not only from a hostile takeover if a board cannot implement a defensive measure to protect it, but also from the feedback provided by the courts upon review, or perhaps more importantly from the expected feedback corporations believe the courts will provide. Given such feedback or expected feedback, a board may then modify its corporate policy to allow defensive measures to survive judicial review. Here, the court is playing a role in accountability that it should leave to the market, which is a source of accountability that provides much better feedback for boards in terms of whether corporate decisions adhere to shareholder wealth maximization. In sum, in the absence of corporate law's triad of filters that can overcome the business judgment rule, court feedback should not substitute for market feedback in the board decision-making process under the *Unocal* test, or in any other area of corporate law.

Of course, the significance of the Link would be minimized if the Link were isolated to the eclectic fact pattern found in *eBay*. If so, then it would simply be considered a sport²³⁰ and be of little significance to corporate law. However, it is doubtful that this will remain the case as the *Unocal* test is meant for public companies, the companies that still dominate the U.S. economy and need to implement defensive measures because they do not have a controlling shareholder or shareholder group to ward off a hostile takeover attempt.²³¹ Already, Delaware courts have begun applying

229. *City Capital Assocs. Ltd. P'ship v. Interco Inc.*, 551 A.2d 787, 796–97 (Del. Ch. 1988) (emphasis added) (footnote omitted) (citation omitted).

230. According to Professor Michael Dooley, a case that has “facts so extreme as to be provocative qualify the case as a ‘sport.’” Dooley, *supra* note 49, at 475.

231. Former Chancellor Chandler notes in the context of rights offerings that “[t]he ample case law addressing rights plans almost invariably involves publicly traded corporations with a widely dispersed, potentially disempowered, and arguably vulnerable stockholder base.” *eBay*, 16 A.3d at 30–31.

the Link to fact patterns involving public companies, as well as influencing scholarly thinking about the *Unocal* test. For example, *Goggin v. Vermillion, Inc.*²³² involved the validity of a poison pill implemented by Vermillion, Inc., a small publicly-traded Delaware corporation with an independent board of directors (except the chairperson) and without a controlling shareholder or shareholder group.²³³ There, Vice Chancellor John W. Noble cited *eBay* for authority when he concluded that “the [p]oison [p]ill would likely ‘fall within the range of reasonableness’ based on what appears to be the directors’ good faith effort to utilize the pill ‘to promote stockholder value.’”²³⁴ Moreover, Chancellor Strine provides a strong defense of Chancellor Chandler’s ruling in the previously mentioned *Wake Forest Law Review* article.²³⁵

Notwithstanding the momentum of incorporating the Link into the first prong of the *Unocal* test, hopefully courts will not apply the Link to defensive measures that a public company implements. The Link is inconsistent with corporate law’s approach to maximizing shareholder wealth.

CONCLUSION

The creation and application of corporate law involves an enduring struggle to find the optimal amount of decision-making autonomy that should be provided to the board of directors. Such an optimal point will lead to the most efficient decision-making in the context of maximizing shareholder wealth. Statutory corporate law tries to achieve this optimal point by providing a large number of default rules and relatively few mandatory rules that it believes to be “market mimicking.”²³⁶ That is, these rules “would be universally adopted by contract, assuming the parties thought about them.”²³⁷ The result is that many of these rules are extremely deferential to board authority. The judiciary, on the other hand, tries to achieve this optimal point in corporate law by using a strategy of maintaining the locus of corporate decision-making in the hands of the board of directors unless the decision is tainted with a conflict of interest, lack of independence, or gross negligence in the process of making the decision. The judiciary takes this approach because it recognizes that the board of directors has a decided competitive advantage in terms of information, decision-making skill, and the ability to make timely decisions.

232. No. 6465–VCN, 2011 WL 2347704 (Del. Ch. June 3, 2011).

233. *See id.* at *1.

234. *Id.* at *5 (quoting *eBay*, 16 A.3d at 28).

235. Strine, *supra* note 32, at 149.

236. Bernard S. Black, *Is Corporate Law Trivial?: A Political and Economic Analysis*, 84 Nw. U. L. REV. 542, 552 (1990).

237. *Id.*

However, when the judiciary diverts corporate decision-making from the board of directors to itself without proper cause, there is a great risk that suboptimal corporate decision-making will occur. As we have already discussed, this is the basic flaw in the *Revlon* duty even though *Lyondell* partially corrected it in the context of director liability. It is also the basic flaw in the *Link*, where a *Revlon*-style review for shareholder wealth maximization is required without the application of corporate law's established triad of filters.

This criticism of the *Link* is not to say that Chancellor Chandler was not a Chancellor of great distinction and many wonderful opinions. However, even the most outstanding jurist gets it wrong from time-to-time. Unfortunately, this is what occurred in *eBay* and it is hoped that the case will be treated as a sport not only in subsequent applications of the *Unocal* test but also in all other cases where, prior to corporate law's established triad of filters, the courts may be tempted to expand its review of corporate decisions for shareholder wealth maximization.